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IN THE

Supreme Court of the United States

STAR SCIENTIFIC, INC.,

Petitioner,

v.

JERRY W. KILGORE,
in his official capacity as Attorney General,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

In the Master Settlement Agreement (MSA), the Attorneys General of 46 States agreed to terminate suits for consumer fraud, antitrust and other violations of state law against the nation's four largest cigarette manufacturers, who together controlled over 97 percent of the domestic market for cigarettes, in return for the manufacturers' agreement to accept certain marketing restrictions and to make payments of hundreds of billions of dollars to the States in perpetuity. These payments, however, depend on the States passing a particular statute, the Qualifying Statute, which was explicitly designed to protect the market share of the settling defendants by obliging manufacturers who had not been sued either to join the MSA or to make burdensome escrow payments for each cigarette sold. This case presents the following questions:

1. Does a state statute, requiring manufacturers either to join the settlement of a lawsuit to which they were not parties or to make payments not required of manufacturers who joined the settlement, discriminate against the non-settling manufacturers in violation of the Equal Protection Clause of the Fourteenth Amendment to the Constitution?

2. Is the Master Settlement Agreement an Interstate Compact requiring the consent of Congress under Article I, § 10 of the Constitution?

3. Does the Virginia Qualifying Statute violate the Commerce Clause "in its dormant state," in so far as it requires a manufacturer to make payments for cigarettes it sold to independent parties outside of Virginia who then exported those cigarettes into Virginia?

CORPORATE DISCLOSURE STATEMENT

Star Scientific, Inc. does not have a parent corporation, and no publicly held corporation owns ten percent or more of Star Scientific's stock.

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Star Scientific, Inc., respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Fourth Circuit in this case.

OPINIONS BELOW

The decision of the district court, dismissing the complaint for failure to state a claim upon which relief can be granted, (App. 42a-63a) is unreported. The decision of the court of appeals affirming the district court (App. 1a-41a) is reported at 278 F.3d 339. The order of the court of appeals denying rehearing and rehearing en banc (App. 64a-65a) is unreported.

STATEMENT OF JURISDICTION

The judgment of the court of appeals was entered on January 22, 2002. On February 19, 2002, the court of appeals denied rehearing and rehearing en banc. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

Reprinted in an appendix to this petition (App. 66a-213a) are the Equal Protection Clause, U.S. Const., Amend. XIV, § 1; the Commerce Clause, U.S. Const., Art. I, § 8, cl. 3; the Compact Clause, U.S. Const., Art. I, § 10, cl. 3; the text and preamble to Va. Code Ann. §§ 3.1-336.1 and 3.1-336.2; and the pertinent provisions of the First Amended Complaint and the Master Settlement Agreement (MSA).[1]

STATEMENT OF THE CASE

In order to receive hundreds of billions of dollars in settlement of serious allegations of misconduct committed by the nation's four largest cigarette manufacturers, 46 States, the District of Columbia and several U.S. Territories agreed to protect those firms' national market shares by extracting

1. Copies of the entire MSA have been lodged with the Clerk of this Court, and the MSA is also available on the Internet at <<http://www.naag.org/tobac/cigmsa.rtf>>.

equivalent per-cigarette payments from firms that have never been accused of similar misconduct. In order to effectuate this scheme, the Attorneys General and legislatures of these jurisdictions undertook concerted action to regulate and cartelize the national market in cigarettes, entrenching the oligopoly position of the "Big Four" tobacco defendants. As the Third Circuit acknowledged in *A.D. Bedell Wholesale Co., Inc. v. Phillip Morris, Inc.*, 263 F.3d 239, 246 (2001), *cert. denied*, 122 S. Ct. 813 (2002), absent doctrines of state antitrust immunity, this arrangement would amount to a classical illicit conspiracy in restraint of trade, designed to allow the Big Four to protect their profits and market shares as they make their payments to the States. This is not only the effect of the arrangement; it is one of its stated purposes. This end is achieved through an ingeniously conceived web of coordinated, cross-referring settlement agreements, consent decrees, and legislation. But as Petitioner Star Scientific, Inc. (Star Scientific) shall show, the participants in this scheme could not weave this web of intricacies without tangling themselves up in several violations of the Constitution. It is not a surprise, after all, that so bold, far-reaching and large-scale a misuse of government power should run afoul of the Nation's basic law.

1. In the wake of specific allegations of wrongdoing by the nation's largest tobacco companies, Mississippi, Minnesota, and West Virginia filed lawsuits in 1994 seeking reimbursement for the health care expenditures they had made on behalf of citizens suffering from tobacco-related diseases. Florida and Massachusetts filed similar suits in 1995, as did thirteen additional States in 1996.[2] Although the specific causes of action differed by State, they shared several common themes. The States claimed that the major tobacco companies (1) misled and deceived the public by suppressing internal research about the

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2. A summary of the state lawsuits and the court documents from those cases can be found on the Internet at <<http://www.library.ucsf.edu/tobacco/litigation/summary.html>>.

risks and addictive properties of cigarettes;[3] (2) committed fraud and engaged in racketeering activity through the Council for Tobacco Research (an industry trade association) and other efforts to disseminate false statements about the addictive nature of nicotine and the adverse health effects of smoking;[4] and (3) were guilty of antitrust violations by, among other things, conspiring to suppress the development and marketing of safer cigarettes.[5] Petitioner Star Scientific was not sued by any State and has never engaged in similar wrongdoing. App. 180a-182a.

On June 20, 1997 a group of state attorneys general and the Big Four tobacco defendants — Philip Morris Incorporated, R.J. Reynolds Tobacco Company, Brown & Williamson Tobacco Corporation, and Lorillard Tobacco Company, who together represented over 97 percent of the cigarette market — announced a proposed resolution to the States' tobacco litigation. *See* Hanoch Dagan & James White, *Governments, Citizens, and Injurious Industries*, 75 N.Y.U.L. REV. 354, 366 (2000). Commonly known as "the Tobacco Resolution," this proposed settlement was to be the basis for federal legislation that would mandate a total reformation and restructuring of how tobacco products are manufactured, marketed and distributed in this country. Although federal legislation to implement the Tobacco Resolution was introduced in the Senate in November 1997, it was not enacted. App. 5a.

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3. *See, e.g., Massachusetts v. Philip Morris*, No. 95-7378, Complaint ¶¶ 185-187 (Middlesex Sup. Ct.); *Washington v. American Tobacco*, No. 94-1707, Complaint ¶¶ 256-257 (Kanawha County Cir. Ct.); *see generally* W. Kip Viscusi, *A Post Mortem on the Cigarette Settlement*, 29 CUMB. L. REV. 523, 526 (1998).

4. *See, e.g., Minnesota v. Philip Morris*, No. 94-8565, Complaint ¶ 103 (2d Judicial Dist.); *Florida v. American Tobacco Co.*, No. CL95-1466, Third Amended Complaint, Counts IV-VIII (15th Judicial Dist.); *see also* Viscusi, *supra*, 29 CUMB. L. REV. at 526.

5. *See, e.g., Minnesota v. Philip Morris, supra*, Complaint ¶ 98; *Massachusetts v. Philip Morris, supra*, Complaint ¶ 202; *see also* Viscusi, *supra*, 29 CUMB. L. REV. at 526.

In the meantime, the Big Four tobacco defendants reached individual settlements with Mississippi, Florida, Texas, and Minnesota. App. 5a. After the defeat of the legislation to implement the Tobacco Resolution, several state attorneys general initiated negotiations with the Big Four in an effort to reach a new multi-state settlement. On November 16, 1998, they reached a new settlement agreement — the MSA — and gave the other state attorneys general seven days in which to become signatories. *Ibid.*

Although the Commonwealth of Virginia had not sued any tobacco companies to recover the cost of providing medical care to Virginia smokers, it decided to sign the MSA. Thus, on December 23, 1998, the Virginia Attorney General filed a lawsuit against the major tobacco companies that was similar to the lawsuits that had been filed in other States. App. 5a-6a.

2. Virginia, the District of Columbia, several Territories, and all of the 45 States that had not already settled with the Big Four tobacco defendants joined the MSA. Under the MSA, there are three groups of tobacco manufacturers. The first group is composed of the Big Four tobacco defendants. They are called "Original Participating Manufacturers" because their representatives participated in the negotiations that led to the MSA. App. 87a.

The second group of manufacturers is the "Subsequent Participating Manufacturers," who signed the MSA after it was executed by the Original Participating Manufacturers. App. 94a. The final group is the "Non-Participating Manufacturers," who have not signed the MSA. *Id.* at 86a. Petitioner Star Scientific is a Non-Participating Manufacturer.

In the MSA, the Settling States agreed to release the Participating Manufacturers from all claims for past misconduct based on the sale, use and marketing of tobacco products. App. 90a-91a. The Settling States also released future monetary claims arising out of exposure to tobacco products, including future claims for reimbursement of health care costs allegedly

associated with the use of or exposure to tobacco products. *Id.* at 91a. But in the Consent Decree and Final Judgment approving the MSA, Virginia specifically stated that only five percent of the monetary payments required to be made to the Commonwealth pursuant to the MSA are attributable to the Commonwealth's Medicaid restitution claim. *Id.* at 22a. Thus, 95 percent of the MSA payments are, by the Commonwealth's own judicial admission, attributable to damages for prior misconduct that Star Scientific has not committed.

In return, all Participating Manufacturers agreed to certain conduct restrictions, including:

> (1) a prohibition on targeting youth in the advertising or marketing of tobacco products (App. 97a);
>
> (2) a ban on the use of cartoon characters to promote cigarette sales (App. 97a);
>
> (3) a limitation of tobacco brand name sponsorships of athletic and other promotional events (App. 97a-102a);
>
> (4) a ban on lobbying Congress to preempt or diminish the Settling States' rights under the MSA (App. 109a-113a), or advocating that the settlement proceeds be used in programs that are not related to tobacco or health (*id.* at 113a);
>
> (5) the dissolution of the Tobacco Institute, the Council for Tobacco Research, and the Center for Indoor Air Research (App. 113a-114a); and
>
> (6) a prohibition on agreements to suppress research into smoking and health (App. 117a-118a), and a ban on misrepresentations regarding the health consequences of tobacco use (*id.* at 118a).

The Participating Manufacturers also agreed to make substantial damage payments to the Settling States. Original Participating Manufacturers owe approximately $12.7 billion in initial damage payments and billions more to be paid in annual payments "in perpetuity." App. 122a-124a. Although the precise amount of these future payments cannot be known with certainty, it is estimated that the Settling States will receive more than $200 billion through 2025. *Id.* at 7a. Virginia is entitled to receive 2.045 percent of these payments, or approximately $4.1 billion through 2025. *Ibid.* In addition, the Original Participating Manufacturers agreed to pay the Settling States' costs and attorneys' fees, including the fees of private lawyers hired by the States who will receive $750 million per year for five years and, thereafter, $500 million per year indefinitely.[6]

In contrast, Subsequent Participating Manufacturers who signed the MSA within 90 days are not required to make *any* payments unless their share of the national cigarette market exceeds the greater of their 1998 market share or 125 percent of their 1997 market share. App. 151a. The payments of the Original Participating Manufacturers are likewise tied to their national market shares, with initial payments based on their relative national market shares in 1997 (*id.* at 122a, 167a), and annual payments based on their relative national market shares in the preceding year (*id.* at 90a, 123a-125a).

The tobacco defendants were concerned that Participating Manufacturers who make these payments might suffer a competitive disadvantage when compared with Non-Participating Manufacturers that could affect the Participating Manufacturers' ability to make required settlement payments. Therefore, in exchange for these payments, the Settling States agreed to the inclusion in the MSA of provisions to protect the market shares and profitability of the Participating Manufacturers. The first of these provisions are the "Non-

6. *See* App. 158a-161a; and Jeremy Bulow & Paul Klemperer, *The Tobacco Deal*, at 38 (Nov. 1998 <http://www.nuff.ox.ac.uk/economics/people/ klemperer.htm>>.

Participating Manufacturer Adjustment" provisions, which state that if the Participating Manufacturers have a combined market share in any year that is more than two percentage points less than the market share they held in 1997 (App. 126a-128a), and the "Firm" — economic consultants selected by the Original Participating Manufacturers and the state attorneys general — determines that the MSA was "a significant factor" in this decline in market share (*id.* at 128a-130a), then each Original Participating Manufacturer that lost market share may *reduce* its damage payments by as much as *three times* its market share loss in excess of two percentage points (*id.* at 126a-127a).

The MSA also requires Settling States to enact "Qualifying Statutes" or "Non-Participating Manufacturer Statutes" to create what the tobacco defendants view as a "level playing field" in the national cigarette market. App. 182a. The MSA defines a "Qualifying Statute" as one that "effectively and fully neutralizes the cost disadvantages that the Participating Manufacturers experience vis-à-vis Non-Participating Manufacturers within such Settling State[s] as a result of the provisions of [the MSA]." *Id.* at 134a. Settling States may enact either the Model Statute in the MSA (*id.* at 168a-176a), or a different statute that serves the same purpose (*id.* at 136a-138a). If a Settling State takes the latter route, the Firm must find that the statute satisfies the MSA "Qualifying Statute" criteria in order for the Settling State to get credit for having enacted a "Qualifying Statute." *Id.* at 136a. A Settling State that fails to enact a Qualifying Statute risks losing some or all of its payments under the MSA. *Id.* at 132a-138a.

Each Settling State must also "diligently enforce[]" its Qualifying Statute (App. 132a), and defend it in any court challenge (App. 136a-138a). To defray the cost of such litigation, the Settling States may obtain disbursements from The States' Antitrust/Consumer Protection Tobacco Enforcement Fund, which was endowed with $50 million from the Original Participating Manufacturers. *Id.* at 164a-166a.

The effect of these provisions was to convert the liability of these specific tobacco defendants into a general increase in the marginal cost of making cigarettes for all manufacturers, whether they committed any wrongdoing or not. Thus, although total cigarette sales have decreased about ten percent, the tobacco revenues of most major tobacco companies have risen, and the Big Four continue to dominate the market with a combined market share of over 95 percent in the year 2001.[7]

3. Virginia enacted the MSA's Model Qualifying Statute in March 1999. The statutory preamble expresses the concern that non-settling tobacco firms might have a "cost advantage." App. 68a. The statute thus requires "[a]ny tobacco product manufacturer selling cigarettes to consumers within the Commonwealth" (1) to join the MSA by becoming a Subsequent Participating Manufacturer, or (2) to pay into escrow (by April 15 of the following year) a specified amount of money for each of its cigarettes sold in the Commonwealth during the year, whether the sale is made by the manufacturer or another party. Va. Code Ann. § 3.1-336.2(A). The escrow payments range from slightly less than one cent per cigarette in 1999 to almost two cents per cigarette in 2007 and each year thereafter, as adjusted for inflation. Va. Code Ann. § 3.1-336.2(A)(2).

Although the interest reverts to the tobacco manufacturer, the escrow payments themselves may be released only under three circumstances. Va. Code Ann. § 3.1-336.2(B).

First, escrow funds may be released to pay a judgment or settlement in a lawsuit brought by the Commonwealth. Va. Code Ann. § 3.1-336.2(B)(1). However, escrow payments must be released "in the order in which they were placed into escrow"

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7. *See* Philip Morris, 10-K for year ending Dec. 31, 2001, at 2; RJR Nabisco, 10-K for year ending Dec. 31, 2001, at 3; Loews Corp. (Lorillard), 10-K for year ending Dec. 31, 2001, at 27; Facts About Brown & Williamson Tobacco Corporation at 1, available at <<http://www.bw.com>>.

and "only to the extent and at the time necessary to make payments required under such judgment or settlement." *Ibid.*

Second, if a manufacturer establishes that it was required to place more money into escrow in a particular year than the Commonwealth's "allocable share of the total payments that [it] would have been required to make in that year under the Master Settlement Agreement . . . had it been a participating manufacturer, the excess shall be released from escrow" and returned to the manufacturer. Va. Code Ann. § 3.1-336.2(B)(2). This provision is an attempt to equalize the escrow payments of nonsettling manufacturers with the settlement payments made by settling manufacturers.

Third, each annual escrow payment will be released from escrow twenty-five years later, assuming that the payment has not already been used to pay a judgment or settlement in favor of the Commonwealth. Va. Code Ann. § 3.1-336.2(B)(3).

4. Star Scientific is a technology-oriented tobacco company which sells StarCure™ low tobacco specific nitrosamine ("TSNA") tobacco, cigarettes and smokeless tobacco products through its wholly-owned subsidiary, Star Tobacco, Inc., formerly Star Tobacco & Pharmaceuticals, Inc. ("ST&P"). App. 186a-187a, 189a-190a. Star Scientific is also a relatively new entrant to the tobacco industry: ST&P did not even begin selling cigarettes to the public until 1994.[8] *Id.* at 189a-190a.

Since the mid-1990s, Star Scientific has focused on developing tobacco-processing technology to reduce certain cancer-causing toxins in tobacco leaf and tobacco smoke. App. 178a-179a, 190a-191a. In October 2000, Star Scientific introduced a new cigarette product called *Advance*® on a test marketing basis. *Id.* at 179a. Although *Advance*® cigarettes had tar and nicotine yields comparable to those of three leading "lights" brand cigarettes, they contained StarCure™ tobacco

8. Between 1990 (when ST&P's predecessor was incorporated) and 1994, ST&P was primarily a contract-manufacturer which manufactured cigars and cigarettes for other companies.

that has substantially reduced levels of carcinogenic TSNAs. *Id.* at 192a. The cigarettes also had a carbon/acetate filter that reduced some toxic gases. *Id.* at 193a.

The back of each pack of *Advance*® cigarettes stated in bold type that **"THERE IS NO SUCH THING AS A 'SAFE' CIGARETTE."** App. 193a. Each package also contained an "onsert" that stated in bold type that **"ALL SMOKED TOBACCO PRODUCTS ARE ADDICTIVE AND POSE SERIOUS HEALTH HAZARDS,"** and **"IT IS STILL BETTER TO *QUIT* THAN TO SWITCH OR SMOKE."**[9] *Id.* at 212a.

Star Scientific also sells four brands of discount cigarettes and has begun to include enhanced warnings on the back of these cigarettes as well.[10] App. 193a, 199a. Star Scientific has never targeted young people in its advertising or disseminated information to undercut the Surgeon General's findings about the dangers of smoking. *Id.* at 181a. Nor has Star Scientific deceived the public about the addictive nature of nicotine or the range of health risks associated with smoking. *Ibid.* Instead, it has attempted to provide the type of enhanced warnings that have been recommended (though not legally required) by the Surgeon General. *Id.*

Star Scientific was not a defendant in any of the States' tobacco lawsuits, and it has never engaged in any of the misconduct alleged in those suits. App. 180a-182a. Furthermore, Star Scientific's research and development efforts contributed

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9. Under an agreement entered in April 2001, Brown & Williamson agreed to take over all aspects of the *Advance*® cigarette and began a test market of the product in Indianapolis, Indiana in November 2001. Under this agreement, Star Scientific receives a royalty on each carton of *Advance*® sold by Brown & Williamson. *See* Star Scientific, 10-K for year ending Dec. 31, 2001, at 4.

10. In 2001 Star Scientific also began to market several low-TSNA smokeless tobacco products. *See* Star Scientific 10-K for year ending Dec. 31, 2001 at 4.

to a substantial decline in revenues from the sale of its cigarettes in 1997 and 1998. *Id.* at 195a. Because a Subsequent Participating Manufacturer's payments under the MSA increase as the manufacturer increases its market share above its 1997 and 1998 levels, and because Star Scientific's market share rose significantly in 1999, it estimated it would have been required to pay approximately $19.8 million during 2000 if it had joined the MSA. *Id.* at 195a-196a. Moreover, Star Scientific's obligations would increase dramatically in response to any future increases in market share above 125 percent of 1997 levels. Such potential payments would place Star Scientific at a severe competitive price disadvantage in the discount cigarette market and deprive the company of capital necessary for further development and sale of low-TSNA tobacco products. *Ibid.* Star Scientific thus decided not to join the MSA.

But as a Non-Participating Manufacturer, Star Scientific is required by the Qualifying Statutes to place in escrow increasingly large amounts of after-tax dollars that will exceed its net income. App. 196a. For example, Star Scientific deposited approximately $11.6 million into escrow in April 2000 to comply with the Qualifying Statutes that had been enacted by the Settling States. *Id.* at 197a. More than $409,000 of these payments went into the escrow account for the benefit of Virginia. *Id.* at 9a-10a. If Qualifying Statutes had been in effect in all Settling States and Territories for the entire year of 1999, Star Scientific's escrow obligation would have been substantially larger. *Id.* at 197a. Star Scientific's escrow payments exceeded its 1999 net income of $11,514,000. *Ibid.* Star Scientific's escrow payments in each subsequent year have likewise exceeded its net income.[11] These escrow payments severely compromise Star Scientific's ability to continue its research and development of potentially less hazardous tobacco products. *Id.* at 198a. Star Scientific therefore filed this suit, seeking to have enforcement of Virginia's Qualifying Statute enjoined.

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11. *See* Star Scientific 10-K for the year ending Dec. 31, 2001, at 14-15.

5. Although sympathetic to Star Scientific's plight, the district court dismissed the complaint. The district court held that Star Scientific lacked standing to challenge the constitutionality of the MSA because "it is not bound by [the MSA's] provisions." App. 52a.

Although the district court found that Star Scientific has standing to challenge Virginia's Qualifying Statute (App. 53a), it dismissed Star Scientific's constitutional challenges for failure to state a claim on which relief can be granted. The district court summarily dismissed Star Scientific's argument that there is no rational basis for imposing payment obligations only on tobacco manufacturers who do not sign the MSA, reasoning that because Star Scientific could have joined the MSA, it cannot complain that it is deprived of the "same benefits" enjoyed by companies who signed the MSA. *Id.* at 55a. The district court also found that the Commonwealth's stated purpose — to provide "a source of recovery for the possible harm caused to the state treasury by a dangerous product" — is a legitimate state purpose. *Ibid.*

The district court went on to note, however, that it is "troubling" that Star Scientific, which "has by all accounts taken every step to provide complete disclosure about the harmful nature of its products, and has embarked upon research into methods that it and many others believe will reduce the toxic nature of cigarettes, must now suffer as a result of the bad faith of previous market entrants." App. 56a. Although Star Scientific "has never been accused of the fraudulent, collusive and intentionally dishonest activities of the Big Four" tobacco defendants, it is also cast as a "villain." *Ibid.* Moreover, the financial burden placed on Star Scientific "may hamper efforts to develop new tobacco technologies." *Id.* Nevertheless, the district court upheld the statute, finding that Virginia had "articulated a rational basis for a classification that pursues a legitimate state purpose." *Id.*

Finally, the district court rejected Star Scientific's Commerce Clause claim, holding that the Qualifying Statute

does not have an impermissible extraterritorial effect and is not excessively burdensome. App. 59a-61a.

6. A two-judge panel of the court of appeals affirmed the judgment of the district court.[12] The court of appeals rejected Star Scientific's equal protection challenge to the Qualifying Statute, holding that

> the distinctions between manufacturers signing the Master Settlement Agreement and manufacturers not signing are rationally related to their status *vel non* as defendants, their willingness to agree to conduct limitations, and Virginia's need to ensure a source of recovery for all future tobacco-smoking related healthcare costs.

App. 20a.

The court of appeals also rejected Star Scientific's argument that it violates the Commerce Clause "in its dormant state" to require Star Scientific to make escrow payments on cigarettes sold to independent distributors in other States if those cigarettes are later exported into Virginia by the independent distributors or other third parties. The court of appeals found no Commerce Clause violation because the Qualifying Statute applies only to cigarettes sold in Virginia (App. 29a) and the burden of policing the subsequent sales of Star Scientific's cigarettes by independent, out-of-state distributors was, in the view of the court of appeals, "minimal." *Id.* at 31a.

Finally, the court of appeals found that Star Scientific has standing to challenge the MSA as an unconstitutional interstate compact, because the MSA is "coercive" in requiring the Commonwealth to pass the Qualifying Statute that injures Star Scientific. App. 36a. But the court of appeals rejected the Compact Clause challenge on the merits, holding that congressional consent was not required because, in the court of

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12. Judge Gregory, the third panel member, recused himself after oral argument. App. 2a.

appeals' view, the MSA neither "'purport[s] to authorize the member States to exercise any powers they could not exercise in its absence,'" nor "derogate[s] from the power of the federal government to regulate tobacco." App. 38a (*quoting United States Steel Corp. v. Multistate Tax Comm'n*, 434 U.S. 452, 473 (1978)).

REASONS FOR GRANTING THE WRIT

The regime established by the MSA and the Qualifying Statutes is extraordinary. By this regime the States undertake the regulation of the national market in a consumer product with annual sales of over $40 billion, limiting entry and protecting the national market share of four manufacturers who pay the States enormous sums annually in return for this protection. If this intricate and ingenious scheme is allowed to stand, it will serve as a template for States assuming the role of Congress in regulating and cartelizing — in return for substantial payments by favored oligopolists — national markets in a wide variety of goods, wherever there is some predicate of possible liability to the State for injury or damage caused by the products. Automobiles, pesticides, chemicals, paint, and firearms are some examples to which this strategy might be applied.

Star Scientific has identified three respects in which this regime violates the Constitution. *First*, the Qualifying Statute violates equal protection. Star Scientific does not question a State's authority to impose high taxes on cigarettes to discourage consumption — so long as the tax applies to all cigarette manufacturers. But a State may not impose burdens only on those companies who declined to join the MSA in order to protect the oligopoly of a few manufacturers who joined the MSA and agreed to pay it large sums of money. The Qualifying Statute thus lacks those "elements of legitimacy and neutrality that must always characterize the performance of the sovereign's duty to govern impartially." *Cleburne v. Cleburne Living Ctr., Inc.*, 473 U.S. 432, 452 (1985). The statutory classification is not rationally related to any legitimate purpose, and the purposes to which it is rationally related are plainly illegitimate.

Second, the scheme violates the Compact Clause. In the MSA, the States agreed not only to adopt uniform regulations, but also to submit the States to collective adjudicative and enforcement mechanisms with final authority to punish deviations from the agreed regime. This effectively creates non-federal, super-state governmental agencies that enable the MSA to regulate the national cigarette market — something that Congress has chosen not to do, and the States could not have done through individual settlements with the big tobacco companies.

These are "important federal question[s] that ha[ve] not been, but should be, settled by this Court." S. Ct. R. 10(c). The court of appeals' decision, if allowed to stand, would signal a complete abandonment of any constitutional discipline — either under the Equal Protection Clause or the Compact Clause — on schemes like the MSA, inviting fresh adaptations of the scheme to a range of businesses limited only by the imagination of lawyers and the greed of state politicians who are delighted to usurp the federal power to regulate national markets and accept substantial payments under settlement agreements that do not have to go through the legislative process applicable to taxes. *See* Dagan & White, *supra*, 75 N.Y.U. L. REV. at 426.

Finally, the Qualifying Statute violates the Commerce Clause in its dormant state in so far as it requires payments for cigarettes sold to independent, out-of-state parties if those cigarettes are later exported into Virginia. The court of appeals' decision upholding this application of the Qualifying Statute is inconsistent with the First Circuit's decision in *Consolidated Cigar v. Reilly*, 218 F.3d 30 (1st Cir. 2000), *rev'd in part on other grounds sub nom., Lorillard Tobacco Co. v. Reilly*, 533 U.S. 525 (2001), and this Court's decision in *Healy v. The Beer Institute*, 491 U.S. 324 (1989).

1. Star Scientific maintains that the Qualifying Statute denies equal protection because it imposes payment obligations only on manufacturers who declined to join the MSA. Star

Scientific acknowledges that where there is no claim of a fundamental right or a suspect class, a statutory classification is subject to rational basis review: Does the *classification* bear a rational relation to a legitimate government purpose? It is this question that the court of appeals answered incorrectly. Star Scientific understands that this Court is not concerned to parse and correct faulty lower court opinions, but where such an opinion ends up sanctioning a startling and far-reaching scheme, the Court's attention is warranted.

In upholding the Qualifying Statute, the court of appeals recited the formulae from *FCC v. Beach Communications, Inc.*, 508 U.S. 307, 313-15 (1993), and other standard authorities describing deferential review of legislative classifications. App. 19a. But the court of appeals mistakenly reasoned as if deferential review meant that the Constitution is satisfied so long as the government comes to court and names a purpose that its classification is allegedly meant to serve. Equal protection, even where no fundamental right or suspect classification is implicated, is not so empty a constraint, as shown in cases such as *Romer v. Evans*, 517 U.S. 620 (1996); *Allegheny Pittsburgh Coal Co. v. County Commission of Webster County*, 488 U.S. 336 (1989); *Cleburne v. Cleburne Living Center, Inc.*, 473 U.S. 432 (1985); *Department of Agriculture v. Moreno*, 413 U.S. 528 (1973); and *Lindsey v. Normet*, 405 U.S. 56 (1972). *See also* Gerald Gunther, *Foreword: In Search of Evolving Doctrine on a Changing Court: A Model For A Newer Equal Protection*, 86 HARV. L. REV. 1, 20-25 (1972).

As Justice Jackson explained in *Railway Express Agency, Inc. v. New York:*

> The framers of the Constitution knew, and we should not forget today, that there is no more effective practical guaranty against arbitrary and unreasonable government than to require that the principles of law which officials would impose upon a minority must be imposed generally. Conversely, nothing opens the

> door to arbitrary action so effectively as to allow those officials to pick and choose only a few to whom they will apply legislation and thus to escape the political retribution that might be visited upon them if larger numbers were affected.

336 U.S. 106, 112 (1949) (Jackson, J., concurring).

The court of appeals offered as the purposes of the Qualifying Statute Virginia's desire that cigarette manufacturers bear the costs of future smoking-related illness, and its interest in reducing smoking — particularly underage smoking — by enforcing certain constraints on cigarette merchandising agreed to in the MSA. But as shown below (*infra* at 18-20), the statutory classification cannot be justified on those grounds, because it is not rationally related to those purposes.

Moreover, the court of appeals erred in ignoring Virginia's prominently stated reason for the classification: to deprive non-settling manufacturers like Star Scientific of a cost advantage over the Big Four tobacco defendants, who must build the cost of their settlement payments into the price of their product. *See* App. 68a, 134a. The statutory scheme is rationally related to that purpose, but that purpose is utterly illegitimate. The statute therefore violates the Equal Protection Clause.

a. A purpose of assuring that tobacco manufacturers bear the future costs of smoking-related illness would be legitimate, and requiring escrow payments from all manufacturers who impose that risk equally would be a rational way of achieving that purpose. But the Qualifying Statute, which exempts MSA participants from that escrow obligation, establishes a classification that is not rationally related to that purpose. The classification cannot be explained, as the court of appeals did, by the fact that the Original Participating Manufacturers are already obligated to make settlement payments that are roughly equivalent to the escrow payments imposed on non-settling firms. App. 20a. As the Commonwealth declared in the Consent Decree approving the MSA — and the court of appeals

accepted (*id.* at 22a) — 95 percent of those payments relate to the settlement of liability for *past* harm inflicted by the Original Participating Manufacturers, none of which has been or could have been charged to Star Scientific. True, under rational basis review, means need not match ends "with razorlike precision," *Kimel v. Florida Bd. of Regents*, 528 U.S. 62, 83 (2000), but a mere five percent match carries a good joke too far.[13]

That is especially true in this case, because the statute disavows any purpose of recovering, on a strict liability-like basis, for future health care costs caused by cigarettes. The statutory preamble makes this clear by explicitly stating that

> it is the policy of the Commonwealth that financial burdens imposed on the Commonwealth by cigarette smoking be borne by tobacco product manufacturers rather than by the Commonwealth *to the extent* that such manufacturers either determine to enter into a settlement with the State or be found [sic] *culpable* by the courts.

App. 68a (emphasis added). To emphasize the point, the preamble further states that the escrow payments are collected only as security for those who "are proven to have acted *culpably*." App. 68a (emphasis added). Thus, contrary to the court of appeals' supposition, the statutory classification cannot be justified by a purpose of having non-culpable cigarette

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13. Nor is this gross disparity much alleviated by the ruse of structuring these payments as escrow payments, returnable after "only 25 years," as the court of appeals found. App. 20a. The complaint alleges (and the allegations must be taken as true on a motion to dismiss) that the statutory payments deprive Star Scientific of its entire net income after taxes. *Id.* at 197a. Moreover, if the escrow-plus-interest feature really served to reduce the inequality of which Star Scientific complains, then it obviously could not achieve the statute's stated purpose of depriving Non-Participating Manufacturers of the "cost advantage" they enjoy from not contributing to the MSA. *Id.* at 68a. The court of appeals cannot have it both ways.

companies like Star Scientific cover future health care costs that the statute is not intended to cover. As this Court has recognized,

> the mere recitation [in court] of a benign, compensatory purpose is not an automatic shield which protects against any inquiry into the actual purposes underlying a statutory scheme. . . . This Court need not in equal protection cases accept at face value assertions of legislative purposes, when an examination of the legislative scheme and its history demonstrates that the asserted purpose could not have been a goal of the legislation.

Weinberger v. Wiesenfeld, 420 U.S. 636, 658 (1975).

The Commonwealth's interest in having tobacco manufacturers bear the future costs of smoking-related illnesses also cannot explain why smaller manufacturers who subsequently joined the MSA are exempt from making any payments under the Qualifying Statute. These Subsequent Participating Manufacturers are not required to make *any* payments under the MSA, *provided* they do not increase their national market share relative to the Original Participating Manufacturers. Even if the purpose of covering the future health care costs imposed by cigarettes were rationally related to a classification that allows the Original Participating Manufacturers to pay only five percent of what non-settling firms must pay, it cannot be rationally related to the classification that allows Subsequent Participating Manufacturers that impose the same health care costs per cigarette to pay zero percent of what non-settling firms must pay. Moreover, because the MSA exemption is based on a lack of growth in market *share* rather than market *volume*, a Subsequent Participating Manufacturer could grow as much as the market does and not pay any health care costs. Indeed, because the exemption is based on *national* market share rather than market share in Virginia, a Subsequent Participating Manufacturer could vastly increase its *share* of

Virginia cigarette sales and never pay a penny toward Virginia's health care costs (so long as its national market share did not rise as well.)

Finally, the Commonwealth's interest in having tobacco manufacturers bear the future costs of smoking-related illnesses does not explain why the Qualifying Statute requires a Non-Participating Manufacturer like Star Scientific to make escrow payments on its cigarette sales in perpetuity, even if it obtains a judgment or enters a settlement resolving all its past and *future* liability for harm caused by its cigarettes. *See* Va. Code Ann. § 3.1-336.2(B). Star Scientific cannot conceive of any legitimate state interest served by a statute that extracts escrow payments for 25 years when there is no possible liability that the escrow payments might be used to satisfy. *See Lindsey v. Normet*, 405 U.S. 56, 77 (1972) (requiring a tenant to file a double bond to appeal a landlord-tenant dispute violates Equal Protection because the landlord is protected by a single bond and thus the discrimination is not warranted).

The court of appeals sought to soften these anomalies by citing the "conduct restrictions" to which the settling manufacturers agreed in the MSA. App. 23a. These are of two sorts: restrictions that might be imposed by general legislation and restrictions whose legislative imposition would violate the Constitution. Compare App. 97a-118a, with *Lorillard Tobacco Co. v. Reilly*, 533 U.S. 525 (2001); *see also* App. 23a. If Virginia is concerned about tobacco sales and marketing practices, it can legislate a general rule imposing otherwise constitutionally permissible restraints on everyone who sells tobacco products in the Commonwealth. The fact that the Participating Manufacturers agreed to otherwise unconstitutional restrictions on their sales and marketing practices in settlement of a lawsuit challenging the legality of their prior practices is not a justification for imposing burdensome payment obligations only on Non-Participating Manufacturers to coerce them to waive their constitutional rights. *See, e.g., Speiser v. Randall*, 357 U.S. 513, 518 (1958).

b. Although the imposition of payment obligations only on Non-Participating Manufacturers is not rationally related to the security purpose cited by the court of appeals, it does serve as an "incentive" to manufacturers to join the MSA. The court of appeals was quite candid about that. App. 24a. If the Qualifying Statute is viewed as a monetary punishment for those who refuse to join the MSA, the anomaly of the free pass offered to the Subsequent Participating Manufacturers disappears. But this governmental purpose is illegitimate. Star Scientific has a due process right not to join a settlement — especially the settlement of a lawsuit in which it had not been sued, and because of its recent appearance in the market and the nature of its practices, could not have been sued. *See, e.g., Ortiz v. Fibreboard Corp.*, 527 U.S. 815, 846 (1999). Star Scientific may not be punished for exercising that constitutional right. *See, e.g., United States v. Goodwin*, 457 U.S. 368, 372 (1982). State legislatures may not impose payment obligations to coerce firms to join settlements.

The Qualifying Statute also serves its stated purpose of protecting the competitive position of the Big Four so that they can make large MSA payments by raising prices without losing their national market shares. A scheme to extract large payments from a few businesses in return for offering them protection from competition is so far from "the performance of the sovereign's duty to govern impartially," *Cleburne*, 473 U.S. at 452, and so close to a classical protection racket, *see Bedell*, 263 F.3d at 246, that it has never before to our knowledge been offered as a legitimating state purpose. The case that comes closest to it treats a purpose of protecting certain firms' market shares against competition from lower cost firms as plainly illegitimate. *See Metropolitan Life Ins. Co. v. Ward*, 470 U.S. 869 (1985) (selectively taxing out-of-state businesses to protect less efficient in-state businesses from competition is not a legitimate state purpose). Yet, stripped of euphemisms, that is precisely the purpose the Commonwealth offers in the MSA (which requires the Commonwealth to enact a statute that

"effectively and fully neutralizes the cost disadvantages that the Participating Manufacturers experience vis-à-vis Non-Participating Manufacturers . . . as a result of the [MSA]") (App. 134a) and in the preamble to the Qualifying Statute itself (which states that the statute is to prevent Non-Participating Manufacturers from using "a resulting cost advantage to derive large, short-term profits . . . without ensuring that the Commonwealth will have an eventual source of recovery from them if they are proven to have acted culpably"). *Id.* at 68a.

The court of appeals thus accepted a purported benign purpose that bore no rational relationship to the statutory classification under any reasonably conceivable set of facts, and ignored the illegitimate purpose that was both closely related to the statutory classification and expressed in the statute itself. In so doing, the court of appeals brought itself into conflict with *Department of Agriculture v. Moreno*, 413 U.S. 528 (1973). There this Court held, in applying rational basis scrutiny, that a court should not accept the government's offer of a legitimating purpose (there, prevention of fraud) which the classification hardly served at all, while ignoring an illegitimate purpose stated in the legislative history (disadvantaging "hippie" households) that fit the classification like a glove. *Id.* at 533-538. In this case, too, the statutory classification is remote and ill-suited to the legitimate purpose offered by the Commonwealth's lawyers, but the illegitimate purpose stated in the Qualifying Statute and MSA fits like a glove

2. The Compact Clause provides that "No State shall, without the Consent of Congress . . . enter into any Agreement or Compact with another State. . . ." U.S. Const., Art. I, § 10, cl. 3. Challenges to legislation under the Compact Clause are rare and have not been successful. But then there never has been an agreement among the States that undertook to regulate the national market in a major consumer product.

The court of appeals conceded that the MSA "establishes a compact among the States, implicating the Compact Clause."

App. 37a. The court of appeals thus correctly recognized that the MSA is more than conscious parallel action among States seeking the benefits of uniformity, as is the case with various uniform laws.

The court of appeals erred, however, in concluding that the MSA is not the type of interstate compact that requires congressional consent under the Compact Clause. The MSA is not simply a device for increasing the States' bargaining power vis-à-vis the tobacco manufacturers, as the court of appeals thought. App. 37a-38a. The payment obligations of each Original Participating Manufacturer to each State are based not on its market share *in that State* but on its *national* market share. Likewise, the Subsequent Participating Manufacturers are exempted from making any payments to the States if they do not increase their *national* market shares. Indeed, the whole MSA is designed to protect the *national* market shares of the Big Four, so they may raise prices and make large payments to the Settling States.

In addition, the Settling States ceded a significant amount of their sovereignty to super-state entities that have the power to make final, non-appealable decisions about such things as: (1) the amount of the payments owed by the Participating Manufacturers and the allocation of those payments among the Settling States (App. 125a-149a); and (2) whether a State has complied with its obligations to enact, defend and "diligently enforce[]" a Qualifying Statute, which determines the size of the MSA payment, if any, that each State receives (*Id.* at 132a). This ensures the collective enactment and enforcement of state Qualifying Statutes that extract payments from non-settling firms in order to create (in the words of the court of appeals, App. 24a) an "incentive" for smaller manufacturers to join the MSA and agree to its *nationwide* restrictions on the advertising and marketing of cigarettes. The States could not have achieved such a national regulation of the cigarette market through individual settlements with the tobacco companies. That is why the court of appeals was wrong to conclude that the MSA

"'does not purport to authorize the member States to exercise any powers they could not exercise in its absence.'" *Id.* at 38a (*quoting Unites States Steel Corp. v. Multi-State Tax Comm'n*, 434 U.S. 452, 473 (1978)).

The court of appeals also erred in concluding that the MSA is not "'directed to the formation of any combination tending to the increase of political power in the States, which may encroach upon or interfere with the just supremacy of the United States.'" App. 36a (*quoting Virginia v. Tennessee*, 148 U.S. 503, 519 (1893)). The court of appeals believed the MSA to be benign because it does not "derogate from the power of the federal government to regulate tobacco." App. 38a. But that is too weak a test. Of course the States cannot derogate from federal authority in the sense that a compact might contradict existing, or preclude future, Congressional action. The Supremacy Clause guarantees that.

The Compact Clause requires congressional authorization — that is, the affirmative action of Congress — because mobilizing a congressional majority to oust state usurpation may be politically difficult. That is particularly true in this case, because the MSA explicitly prohibits Participating Manufacturers from

> support[ing] or caus[ing]to be supported (including through any third party or Affiliate) in Congress or any other forum legislation or rules that would preempt, override, abrogate or diminish such Settling State's rights or recoveries under this Agreement.

App. 112a-113a.

That is why the Framers made invalidity the default rule. This, like the balance of power between the States and Federal Government, and the balance between the Executive and Congress, is a structural provision that requires definition and enforcement by the judicial branch. Because Congress did not

consent to the MSA, it is an unconstitutional interstate compact.[14]

3. The court of appeals also erroneously held that the Qualifying Statute may require Star Scientific to make escrow payments not only for cigarettes it sells in Virginia, but also for cigarettes it sells to independent distributors in other States if the distributors (or other third parties) later export the cigarettes into Virginia. The court of appeals unaccountably failed to advert to the inconsistency between its conclusion and that of the First Circuit's decision in *Consolidated Cigar Corp. v. Reilly*, *supra*. Its decision is also inconsistent with the dormant Commerce Clause principles announced by this Court in *Healy v. The Beer Institute*, *supra*.

a. *Consolidated Cigar* involved a Commerce Clause challenge to Massachusetts regulations requiring that the packages of all cigars sold in Massachusetts contain a warning, and imposing "liability on a manufacturer whenever one of its cigars appears in Massachusetts without the required warning, even when the sale is conducted by third parties without the knowledge or consent of the manufacturer." 218 F.3d at 57. The First Circuit recognized that, as a practical matter, the

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14. In the court of appeals, the Commonwealth argued that Congress impliedly consented to the MSA when it enacted a technical amendment to the Medicaid statute (codified at 42 U.S.C. § 1396b(d)(3)(B)) that resolved, in the States' favor, the uncertain question whether moneys the States might receive in various suits against tobacco companies were subject to the general provisions in the Medicaid statute allowing the federal government to receive a portion of Medicaid funds recouped by the States from third parties. But the court of appeals did not rule on this claim. Particularly in light of the fact that Congress was unable to reach agreement on the Tobacco Resolution, which would explicitly have given Congressional consent to the proposed comprehensive nationwide tobacco settlement that preceded the MSA, *see supra* at 3, there is no reason to infer that Congress consented to the vast MSA compact by enacting a technical Medicaid amendment disclaiming any federal interest in moneys received by States under any tobacco settlement.

regulations gave manufacturers "no choice but to include the Massachusetts warnings on all packages, just in case one should later appear in Massachusetts through unforeseen channels." *Ibid.* In this respect, the court held, the "benefit derived from the regulations is clearly outweighed by the substantial burdens placed on interstate commerce." *Id.* at 58 (applying the balancing test of *Pike v. Bruce Church, Inc.*, 307 U.S. 137, 142 (1970)).

That reasoning is equally applicable to this case. The only way that Star Scientific can be sure that it is in compliance with the Qualifying Statute — and avoid the concomitant charges and penalties — is to sell only to Virginia distributors and retailers or to sell to out-of-state distributors at a cost that includes the escrow amount in anticipation that the product might be resold into Virginia, which would make the product noncompetitive in States that are not subject to the MSA. Even the expedient of contractually binding out-of-state independent distributors to assist it in complying with Virginia law will not assure that they will do so. Thus, the Qualifying Statute unreasonably burdens interstate commerce because Star Scientific does not control to whom distributors in other States resell their products and, as in *Consolidated Cigar*, is not in a position to anticipate what products will end up in Virginia.

In holding that the local benefits of the Qualifying Statute outweigh the burden on interstate commerce, the court of appeals not only ignored this burden, but also failed to recognize that Virginia's interest "could be promoted as well with a lesser impact on interstate activities." *Pike v. Bruce Church, Inc.*, 397 U.S. at 142. The Commonwealth could have drafted the Qualifying Statute to mirror its excise tax statute and to impose the payment obligation on the distributor who sells the cigarettes into Virginia, rather than on the manufacturer. *See infra* at 27.

b. The court of appeals' holding is also inconsistent with this Court's decision in *Healy*. Although it acknowledged that the Commerce Clause prohibits a State from enacting a law

that has "the 'practical effect' of regulating commerce occurring wholly outside the State's borders" (App. 28a, *quoting Healy*, 491 U.S. at 332), the court of appeals erroneously held that the Qualifying Statute has no such extraterritorial effect because it "specifically limits its applicability to the sale of cigarettes 'within the Commonwealth.'" App. 29a (*quoting* Va. Code Ann. § 3.1-336.2(A)). This reasoning would be sound if the Qualifying Statute imposed the payment obligation on the distributor who sold the cigarettes in Virginia, as does the excise tax law. Va. Code. Ann. §§ 58.1-1001, 58.1-1003. In that case, the law would regulate a sale that occurs in Virginia. In this case, however, the Qualifying Statute requires the *manufacturer* to pay escrow for cigarettes it sells to distributors in other States, if those cigarettes are later exported by independent third parties into Virginia. As applied to this situation, the Qualifying Statute has the "undeniable effect" (*Healy*, 491 U.S. at 337) of controlling an out-of-state transaction: the manufacturer's sale of cigarettes to a distributor in another State.

It is no answer to say, as the court of appeals does, that Star Scientific could require its independent distributors in other States to keep track of their sales into Virginia (App. 31a), to refrain from making such sales, or to indemnify Star Scientific if they do. That argument simply demonstrates that the Qualifying Statute has the practical effect of regulating commercial transactions concluded beyond Virginia's borders, and thus is per se unconstitutional under *Healy*, 491 U.S. at 337-340.

CONCLUSION

For the foregoing reasons, the petition for certiorari should be granted.

Respectfully submitted,

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APPENDIX

APPENDIX A — OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT DECIDED JANUARY 22, 2002

UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

No. 01-1502

STAR SCIENTIFIC, INCORPORATED,
a Delaware corporation,

Plaintiff-Appellant,

v.

RANDOLPH A. BEALES, in his official capacity as Attorney General,

Defendant-Appellee.

DKT LIBERTY PROJECT; ALABAMA; ALASKA; ARIZONA; ARKANSAS; CALIFORNIA; CONNECTICUT; DELAWARE; THE DISTRICT OF COLUMBIA; GEORGIA; HAWAII; IDAHO; ILLINOIS; INDIANA; IOWA; KANSAS; KENTUCKY; LOUISIANA; MAINE; MARYLAND; MASSACHUSETTS; MICHIGAN; MINNESOTA; MISSOURI; MONTANA; NEBRASKA; NEVADA; NEW HAMPSHIRE; NEW JERSEY; NEW MEXICO; NEW YORK; NORTH CAROLINA; NORTH DAKOTA; NORTHERN MARIANA ISLANDS; OHIO; OKLAHOMA; OREGON; PENNSYLVANIA; PUERTO RICO; SOUTH CAROLINA; SOUTH DAKOTA; TENNESSEE; UTAH; VERMONT; WASHINGTON;

Appendix A

WEST VIRGINIA; WISCONSIN; WYOMING; AMERICAN LEGACY FOUNDATION; AMERICAN CANCER SOCIETY; AMERICAN HEART ASSOCIATION; AMERICAN LUNG ASSOCIATION; NATIONAL CENTER FOR TOBACCO-FREE KIDS,

Amici Curiae.

Appeal from the United States District Court
for the Eastern District of Virginia, at Richmond.
James R. Spencer, District Judge.
(CA-00-835-3)

Argued: November 1, 2001

Decided: January 22, 2002

Before NIEMEYER, WILLIAMS, and GREGORY,*
Circuit Judges.

Affirmed by published opinion. Judge NIEMEYER wrote the opinion, in which Judge WILLIAMS joined.

OPINION

NIEMEYER, Circuit Judge:

Star Scientific, Inc., a cigarette manufacturer, challenges the constitutionality of the Master Settlement Agreement of

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* Judge Gregory heard oral argument in this case but has since recused himself. The decision is filed by a quorum of the panel pursuant to 28 U.S.C. § 46(d).

November 16, 1998, between the Commonwealth of Virginia — as well as 45 other States — and the major tobacco manufacturers. It also challenges the constitutionality of legislation enacted by the Commonwealth of Virginia to qualify it to receive payments under the Master Settlement Agreement.

To settle the States' lawsuits against the major tobacco manufacturers arising from their development and marketing of cigarettes, Virginia and the 45 other States, as well as the District of Columbia and 5 territories, entered into a Master Settlement Agreement with Phillip Morris, Inc., R.J. Reynolds Tobacco Company, Brown & Williamson Tobacco Corporation, and Lorillard Tobacco Company. The Master Settlement Agreement calls for the tobacco manufacturers to pay the States, in exchange for releases from liability for past and future damages, approximately $200 billion over the next 25 years, including approximately $4.1 billion to the Commonwealth of Virginia.

Star Scientific, which contends that it has not engaged in the misconduct attributed to the major tobacco manufacturers and was not sued by any of the States, asserts that it will be unjustly burdened by the requirements of the Master Settlement Agreement and the legislation that Virginia enacted pursuant to the agreement. It therefore commenced this action to challenge the constitutionality of both the settlement agreement and the statute. The district court granted Virginia's motion to dismiss the complaint under Federal Rule of Civil Procedure 12(b)(6).

On appeal, Star Scientific contends that the statute enacted pursuant to the Master Settlement Agreement,

Va. Code Ann. §§ 3.1-336.1 & 3.1-336.2, violates its rights under the Due Process, Equal Protection, and Commerce Clauses of the United States Constitution. It also contends that the Master Settlement Agreement itself violates the Compact Clause.

For the reasons that follow, we affirm.

I

In 1994, the Attorneys General of Mississippi, Minnesota, West Virginia, and Massachusetts filed lawsuits in their respective State courts against the major tobacco manufacturers, Phillip Morris, R.J. Reynolds, Brown & Williamson, and Lorillard, seeking reimbursement for healthcare expenditures made by those states on behalf of citizens suffering from tobacco-related diseases. By 1996, 15 additional states had filed similar suits. Although the States' respective complaints varied, they shared a common theme, alleging that the major tobacco companies (1) had misled and deceived the public by suppressing internal research about the risks and addictive properties of cigarettes, (2) had committed fraud and had engaged in racketeering activity through their efforts to disseminate false statements about the addictive nature of nicotine and the adverse health effects of smoking, and (3) had violated antitrust laws by, among other things, conspiring to suppress the development and marketing of safer cigarettes.

By 1997, after several more States had filed similar lawsuits, the major tobacco manufacturers negotiated with a group of State Attorneys General to reach a comprehensive nationwide settlement of the claims. The settlement, which was

known as "the Tobacco Resolution," was contingent on congressional approval. Accordingly, federal legislation to implement the Tobacco Resolution was introduced in the Senate in November 1997. The major tobacco manufacturers, however, withdrew their support of this legislation when it appeared that the legislation would require them to pay more money and accept greater regulatory and marketing restrictions than they had agreed to in the Tobacco Resolution. Thus, the legislation was never enacted.

In the meantime, the major tobacco companies reached individual settlements with Mississippi, Florida, Texas, and Minnesota. And, upon failure of the Tobacco Resolution, several other State Attorneys General initiated negotiations with two of the tobacco companies on a new multi-state settlement. On November 16, 1998, a group of State Attorneys General and the major tobacco manufacturers reached an agreement called the "Master Settlement Agreement." This agreement permitted nonsettling States to participate if they acted within seven days.

The Commonwealth of Virginia, which had not participated in the original settlement discussions, decided to join the Master Settlement Agreement and, for that purpose, commenced an action in State court against Brown & Williamson, Liggett Group, Inc., Lorillard, Phillip Morris, R.J. Reynolds, and United States Tobacco Company on December 23, 1998. In its complaint, Virginia alleged that it spends millions of dollars each year to pay healthcare costs caused by tobacco-related diseases. It contended that the tobacco companies misrepresented the health effects of tobacco while simultaneously suppressing research revealing

the dangers of tobacco products. The complaint also asserted that the defendants acted in concert to suppress research and preserve their markets. Finally, it alleged that the companies specifically targeted youth in their advertisements and marketing campaigns "to induce such persons to start using tobacco products and increase [the manufacturers'] sales of tobacco products." The complaint alleged violations of the Virginia Antitrust Act, the Virginia Consumer Protection Act, and claims for unjust enrichment and restitution, and sought declaratory relief, injunctive relief, restitution, damages, costs, and attorneys fees.

After filing its complaint, Virginia, along with the other 45 states that had not already settled with the major tobacco companies, the District of Columbia, and 5 territories, agreed to sign on to the Master Settlement Agreement. Virginia's litigation in State court was accordingly terminated by a consent decree and final judgment, dated February 23, 1999, providing that "the [Master Settlement Agreement] set forth therein, and the establishment of the escrow provided for therein are hereby approved in all respects, and all claims are hereby dismissed with prejudice as provided therein." Star Scientific was not named a defendant in that action and did not participate in the Master Settlement Agreement.

Under the Master Settlement Agreement, the States released the participating tobacco manufacturers from all claims for past conduct based on the sale, use, and marketing of tobacco products. They also released future monetary claims arising out of exposure to tobacco products, including future claims for reimbursement of healthcare costs allegedly associated with the use of or exposure to tobacco products.

Appendix A

In return, the participating tobacco manufacturers agreed to conduct restrictions and to annual payments to the States. Among the conduct restrictions were agreements (1) to refrain from targeting youth in the advertising and marketing of tobacco products; (2) to refrain from using cartoon characters to promote cigarette sales; (3) to limit tobacco brand-name sponsorships of athletic and other events; (4) to refrain from lobbying Congress to preempt or diminish the States' rights under the Master Settlement Agreement or to advocate that settlement proceeds under the Master Settlement Agreement be used for programs other than those related to tobacco or health; (5) to dissolve the Tobacco Institute, the Council for Tobacco Research, and the Center for Indoor Air Research; and (6) to refrain from suppressing research relating to smoking and health and misrepresenting the dangers of using tobacco products. The participating manufacturers also agreed to make annual payments "in perpetuity" for the damages caused to the States. It is estimated that through these payments, the States will receive more than $200 billion through 2025, of which Virginia will receive 2.045% or approximately $4.1 billion. Finally, the participating manufacturers agreed to pay the States' costs and attorneys fees.

The Master Settlement Agreement permits other tobacco companies to participate in the benefits of the agreement as "Subsequent Participating Manufacturers." Subsequent Participating Manufacturers are not required to make any payments under the Master Settlement Agreement unless their share of the national cigarette market exceeds the greater of their 1998 market share or 125% of their 1997 market share. Any payments that would be required would be tied to the Subsequent Participating Manufacturers' market shares.

Appendix A

Because of a concern that manufacturers participating in the Master Settlement Agreement might suffer a competitive disadvantage when compared to nonparticipating manufacturers and that this disadvantage could affect the participating manufacturers' ability to make the settlement payments, the Master Settlement Agreement includes provisions to protect the market shares and profitability of the participating manufacturers. Thus, one provision of the Master Settlement Agreement allows for participating manufacturers to reduce their damage payments if they lose market share during a given year, as determined by the "Firm," a group of economic consultants designated under procedures established in the Master Settlement Agreement. In addition, the Master Settlement Agreement requires the States to enact a qualifying statute that "effectively and fully neutralizes the cost disadvantages that the Participating Manufacturers experience vis-a-vis Non-Participating Manufacturers within such Settling State[s] as a result of the provisions of this Agreement." If a State does not enact and "diligently enforce[ ]" a qualifying statute, it can lose future payments under the Master Settlement Agreement.

Virginia enacted a qualifying statute in March 1999 in a form substantially similar to the model qualifying statute included in the Master Settlement Agreement. *See* Va. Code Ann. §§ 3.1-336.1 & 3.1-336.2. Virginia's qualifying statute provides that any tobacco manufacturer "selling cigarettes to consumers within the Commonwealth," whether directly or indirectly, shall (1) become a participating manufacturer and sign the Master Settlement Agreement, or (2) place into an escrow fund an amount determined by the number of cigarettes that the nonparticipating manufacturer sells in Virginia. The amount ranges from slightly less than one cent per cigarette

in 1999 to almost two cents per cigarette in the year 2007 and thereafter, adjusted for inflation. *Id.* § 3.1-336.2.A.2. Any non-participating tobacco manufacturer failing to comply with the duties imposed by the qualifying statute becomes subject to a civil fine and ultimately to loss of the privilege of selling cigarettes to consumers in Virginia. *Id.* § 3.1-336.2.C.

The escrow fund established by the statute is to be used to pay any judgment or settlement in a lawsuit brought by Virginia to recover on a claim (of the kind released in the Master Settlement Agreement) against a nonparticipating manufacturer. Otherwise, the escrow funds are returned to the nonparticipating manufacturer either annually to the extent that they exceed what that manufacturer would have paid had it participated under the Master Settlement Agreement or completely after 25 years. In the interim, all interest earned on the escrow account is paid to the manufacturer. Va. Code Ann. § 3.1-336.2.B.

Star Scientific, a "technology-oriented" tobacco company that focuses on developing tobacco-processing technology to reduce certain cancer-causing toxins in tobacco leaf and tobacco smoke, began operations in 1990. It did not participate in the Master Settlement Agreement because of the financial burden of the required payments. The company estimated that under the agreement, it would have to pay approximately $19.8 million during 2000 and more thereafter. It asserts that it never engaged in the misconduct alleged against the major manufacturers by the States, and it was never sued by the States. Accordingly, Star Scientific elected — albeit under duress — to comport with the requirements of the qualifying statutes. It deposited approximately $11.6 million in escrow in April 2000, approximately $409,000 of

which was attributable to the sale of cigarettes in Virginia under Virginia's qualifying statute.

Because of the substantial payments required by the States' various qualifying statutes, Star Scientific commenced this action, seeking to have Virginia's qualifying statute declared unconstitutional and enjoined. It alleged in its complaint that the statute deprives Star Scientific of its rights under the Due Process, Equal Protection, Commerce, and Takings Clauses of the United States Constitution. It also challenged the Master Settlement Agreement, arguing that the agreement is an unconstitutional interstate compact because it has not received congressional authorization, as required by the Compact Clause of Article I, § 10 of the Constitution.

On Virginia's motion, made under Federal Rule of Civil Procedure 12(b)(6), the district court dismissed Star Scientific's complaint. The court ruled that Star Scientific lacked standing to challenge the Master Settlement Agreement under the Compact Clause because Star Scientific could not allege an injury that was "concrete and particularized," nor could it show any legal prejudice caused by the Master Settlement Agreement. The court recognized that Star Scientific had standing to challenge Virginia's qualifying statute, but it dismissed all of Star Scientific's constitutional challenges to the statute for failure to state a claim on which relief could be granted.

From the district court's judgment dismissing the complaint, Star Scientific filed this appeal. Star Scientific did not, however, appeal the district court's ruling on its Takings Clause claim.

Appendix A

II

Star Scientific contends first that Virginia's qualifying statute — Va. Code Ann. §§ 3.1-336.1 & 3.1-336.2 — violates its rights under the Due Process Clause. It argues that the statute unconstitutionally aims effectively to neutralize the economic impact of the Master Settlement Agreement on the participating manufacturers by placing equivalent financial burdens on the nonparticipating manufacturers, who are competitors of the participating manufacturers. The statute accomplishes this end, they argue, by depriving non-participating competitors, such as Star Scientific, of their property for 25 years either to force them to sign the Master Settlement Agreement or to impose on them ā competitive disadvantage that they otherwise would not have suffered because they engaged in no wrongdoing.

Star Scientific focuses on two legislative means which it asserts are illegal. First, it contends that the State deprives Star Scientific of its property without due process of law by forcing it to pay its funds into an escrow account for 25 years, citing to *Eastern Enterprises v. Apfel*, 524 U.S. 498, 547 (1988) (Kennedy, J., concurring in judgment and dissenting in part); *id.* at 556-57 (Breyer, J., dissenting); *North Ga. Finishing, Inc. v. Di-Chem, Inc.*, 419 U.S. 601, 606 (1975). Second, it contends that Virginia seeks to compel it to sign an agreement settling a case to which it was not a party and for which it could not be made a party. Star Scientific contends that in an effort to force non-signing parties to join the Master Settlement Agreement, Virginia disadvantages nonparticipating manufacturers such as Star Scientific because their payments in escrow are not tax deductible. It asserts that this purpose

is impermissible because it is unconstitutional for "an agent of the State to pursue a course of action whose objective is to penalize a person's reliance on his legal rights" (quoting *United States v. Goodwin*, 457 U.S. 368, 372 n.4 (1982) (internal quotation marks and citation omitted)).

In response, Virginia argues that the qualifying statute is designed to protect the physical and fiscal health and welfare of the Commonwealth and thus is a constitutionally sound exercise of the State's police powers. The Commonwealth asserts that the statute serves the expressly stated legitimate purpose of providing a source of recovery for the smoking-related healthcare costs that it will inevitably be forced to bear. It concludes that, under rational basis review, the existence of this legitimate purpose ends the due process inquiry. The district court agreed with the Commonwealth and dismissed Star Scientific's due process claim.

"In reviewing a district court's order dismissing a complaint under Federal Rule of Civil Procedure 12(b)(6) for plaintiff's 'failure to state a claim upon which relief can be granted,' we determine *de novo* whether the complaint, under the facts alleged and under any facts that could be proved in support of the complaint, is legally sufficient." *Eastern Shore Mkts., Inc. v. J.D. Assoc. Ltd. Partnership*, 213 F.3d 175, 180 (4th Cir. 2000).

The Due Process Clause includes a substantive component that provides some protection against economic legislation interfering with property interests. *See, e.g., Concrete Pipe & Prods. of Cal., Inc. v. Constr. Laborers Pension Trust for So. Cal.*, 508 U.S. 602, 636-37 (1993); *Usery v. Turner*

Elkhorn Mining Co., 428 U.S. 1, 14-15 (1976). This protection, however, is severely limited. The Supreme Court has long recognized that "[t]he day is gone when this Court uses the Due Process Clause of the Fourteenth Amendment to strike down state laws, regulatory of business and industry conditions, because they may be unwise, improvident, or out of harmony with a particular school of thought." *Williamson v. Lee Optical of Okla.*, 348 U.S. 483, 488 (1955); *see also Ferguson v. Skrupa*, 372 U.S. 726, 730 (1963) ("We have returned to the original constitutional proposition that courts do not substitute their social and economic beliefs for the judgment of legislative bodies, who are elected to pass laws").

To comport with the limited scope of substantive due process protection, economic legislation need only be rationally related to a legitimate government interest. *See, e.g., Concrete Pipe*, 508 U.S. at 637; *Duke Power Co. v. Carolina Environmental Study Group*, 438 U.S. 59, 84 (1978); *Holland v. Keenan Trucking Co.*, 102 F.3d 736, 740 (4th Cir. 1996) ("If a piece of economic legislation 'is supported by a legitimate legislative purpose furthered by [a] rational means, judgments about the wisdom of such legislation remain within the exclusive province of the legislative and executive branches' ") (quoting *Pension Benefit Guar. Corp. v. R.A. Gray & Co.*, 467 U.S. 717, 729 (1984)). Under rational basis review, therefore, "there is no need for mathematical precision in the fit between justification and means," *Concrete Pipe*, 508 U.S. at 639, and "the law need not be in every respect logically consistent with its aims to be constitutional. It is enough that there is an evil at hand for correction, and that it might be thought that the particular legislative measure was a rational way to correct it." *Lee Optical*, 348 U.S. at 487-88. Moreover,

economic legislation "come[s] to the Court with a presumption of constitutionality, and . . . the burden is on one complaining of a due process violation to establish that the legislature has acted in an arbitrary and irrational way." *Usery*, 428 U.S. at 15. Thus, "[i]t is difficult to exaggerate the burden" that a party must overcome to demonstrate that economic legislation fails rational basis review. *Holland*, 102 F.3d at 740.

The courts defer to rational legislative decisionmaking with respect to economic legislation because the legislatures are better equipped to consider and evaluate the "profound and far reaching consequences" that such legislation may have. *Duke Power Co.*, 438 U.S. at 83. Thus, the Supreme Court has admonished that "it is for the legislature, not the courts, to balance the advantages and disadvantages" of economic legislation. *Lee Optical*, 348 U.S. at 487. This deference is appropriate because the people may "resort to the polls" to protect themselves against abuses by the legislature. *Id.* at 488 (quoting *Munn v. Illinois*, 94 U.S. 113, 134 (1876)).

Now applying this highly deferential standard, we determine whether Star Scientific has demonstrated that the Virginia General Assembly "acted in an arbitrary and irrational way" when it passed its qualifying statute. *See Usery*, 428 U.S. at 15.

The qualifying statute at issue — Va. Code Ann. §§ 3.1-336.1 & 3.1-336.2 — was passed with a fully articulated purpose. In the preamble to the legislation, the Virginia General Assembly stated that cigarette smoking "presents serious public health concerns" which in turn present "serious

financial concerns for the Commonwealth." It stated that it was therefore adopting the policy that "financial burdens imposed on the Commonwealth by cigarette smoking be borne by tobacco product manufacturers rather than by the Commonwealth to the extent that such manufacturers either determine to enter into a settlement with the State or be found culpable by the courts." Against these background facts and the policy announced, the Virginia General Assembly articulated the purpose of the qualifying statute, as follows:

> Whereas, it would be contrary to the policy of the Commonwealth if tobacco product manufacturers who determine not to enter into such a settlement could use a resulting cost advantage to derive large, short-term profits in the years before liability may arise without ensuring that the Commonwealth will have an eventual source of recovery from them if they are proven to have acted culpably. It is thus in the interest of the Commonwealth to require that such manufacturers establish a reserve fund to guarantee a source of compensation and to prevent such manufacturers from deriving large, short-term profits and then becoming judgment-proof before liability may arise.

In short, the statute's stated purpose is to ensure that Virginia will be able to recover healthcare costs from cigarette manufacturers regardless of whether the manufacturer has signed on to the Master Settlement Agreement. Giving effect to this purpose falls within the State's police power to promote the public health of the State and "do[es] not run afoul of some specific federal constitutional prohibition, or

of some valid federal law." *Ferguson*, 372 U.S. at 730-31 (quoting *Lincoln Fed. Labor Union v. Northwestern Iron & Metal Co.*, 335 U.S. 525, 536 (1949)). Because the qualifying statute unquestionably has a legitimate purpose, the only viable remaining question is whether the statute is rationally related to furthering this purpose.

The statute requires that tobacco manufacturers who have not signed the Master Settlement Agreement place funds in escrow in proportion to the number of cigarettes that they sell in Virginia, directly or through intermediaries. The funds are held to secure any claim by the Commonwealth against the manufacturer for health-related claims arising from cigarette smoking. While we recognize the financial burden that such payments might create for any given cigarette manufacturer — a burden represented by the loss of use of significant amounts of money for 25 years — we note that the State surely could properly accomplish the same end by enacting a more financially burdensome form of legislation, such as an act imposing a tax on cigarette manufacturers but giving a tax credit to those who sign the Master Settlement Agreement. Under the escrow arrangement, the manufacturer receives interest currently on the funds in the escrow account and the full principal not used to pay judgments after 25 years. This mechanism is rationally related to the stated purpose of the statute, and beyond that we must leave the weighing of interests and the wisdom of the legislation to the legislature. *See Ferguson*, 372 U.S. at 731 (recognizing the "social utility" of debt adjusting, but nonetheless upholding a law that allowed only lawyers to engage in debt adjusting and, therefore, put out of business nonlawyer debt adjusters). Stated differently, because the creation of the escrow account is rationally related to Virginia's legitimate purpose of

ensuring that it can recover future judgments against nonparticipating tobacco manufacturers, we defer to the legislature's judgment that the qualifying statute is the best way of dealing with the possibility of culpable manufacturers becoming judgment proof in the future. *See Duke Power*, 438 U.S. at 83-84 (noting that the fact that the legislation has "profound and far-reaching consequences . . . provides all the more reason for this Court to defer to the congressional judgment unless it is demonstrably arbitrary or irrational").

Star Scientific's challenge to the qualifying statute is based on a rejection of the statute's articulated purpose. It would rather infer that the statute was enacted to coerce cigarette manufacturers to sign on to the Master Settlement Agreement. This argument ignores the fact that even if we were to reject the State's articulated purpose for enacting the statute, we would then need only determine that the legislation has some conceivable purpose that is not prohibited by the Constitution. *See Lee Optical*, 348 U.S. at 487 (considering various purposes on which the legislature "might" have based the legislation at issue); *see also Minnesota v. Cloverleaf Creamery Co.*, 449 U.S. 456, 463 n.7 (1981) (noting that, in equal protection analysis, the "Court will assume that the objectives articulated by the legislature are actual purposes of the statute, unless an examination of the circumstances forces us to conclude that they 'could not have been a goal of the legislation' " (quoting *Weinberger v. Wiesenfeld*, 420 U.S. 636, 648 n.16 (1975))). Obviously, one of the conceivable purposes of the statute is the legitimate purpose stated by Virginia and to which the means adopted rationally relates. Accordingly, we agree with the district court that the qualifying statute does not violate the Due Process Clause of the United States Constitution.

Appendix A

III

Star Scientific next contends that Virginia's qualifying statute violates its rights under the Equal Protection Clause. It argues that the statute treats tobacco companies differently based on whether or not they joined the Master Settlement Agreement, and that this differential treatment is not rationally related to a legitimate government purpose. Star Scientific asserts first that the statute's purpose is to protect the market share of the four largest cigarette manufacturers and that this protectionist purpose is illegitimate. Second, it argues that even if the purpose of the statute is to ensure a source of recovery for health care costs imposed on Virginia by cigarette smoking, this purpose is not rationally fulfilled by imposing the requirements of the qualifying statute only on nonparticipating members.

In response, Virginia contends that the different classifications of cigarette manufacturers under the qualifying statute are rationally related to the overall purpose of providing a source of recovery for healthcare costs. Just as participating manufacturers are required to make payments under the Master Settlement Agreement for past and future damages, nonparticipating members are required to put money into escrow which is held only for assuring that the non-participating manufacturers' future liability is satisfied. In either case, Virginia's future costs resulting from cigarette smoking are placed on the tobacco manufacturers who sell cigarettes in the State.

Like the analysis used in evaluating the constitutionality of economic legislation under the Due Process Clause, an analysis of economic legislation under the Equal Protection Clause

is a deferential one. "In areas of social and economic policy, a statutory classification that neither proceeds along suspect lines nor infringes fundamental constitutional rights must be upheld against equal protection challenge if there is any reasonably conceivable state of facts that could provide a rational basis for the classification." *FCC v. Beach Communications, Inc.*, 508 U.S. 307, 313 (1993). Stated otherwise, a statutory classification that neither employs inherently suspect distinctions nor burdens the exercise of a fundamental constitutional right will be upheld if the classification is rationally related to a legitimate state interest. *See, e.g., Cloverleaf Creamery*, 449 U.S. at 461; *City of New Orleans v. Dukes*, 427 U.S. 297, 303 (1976). This rational basis review is "a paradigm of judicial restraint." *Beach Communications*, 508 U.S. at 314. Thus, "those attacking the rationality of the legislative classification have the burden 'to negative every conceivable basis which might support it.' Moreover, . . . it is entirely irrelevant for constitutional purposes whether the conceived reason for the challenged distinction actually motivated the legislature." *Dukes*, 427 U.S. at 314 (internal citations omitted) (quoting *Lehnhausen v. Lake Shore Auto Parts Co.*, 410 U.S. 356, 364 (1973)).

Turning to whether Virginia's qualifying statute violates the Equal Protection Clause, we conclude that Star Scientific has not met its very difficult burden. Although it is true that the qualifying statute creates distinctions among tobacco manufacturers based on whether a manufacturer signs the Master Settlement Agreement, the distinctions are rationally related to Virginia's legitimate purpose of ensuring a source of recovery from all manufacturers for Virginia's future costs related to cigarette smoking.

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For those manufacturers sued by Virginia for wrongdoing, the Master Settlement Agreement mandates not only strict conduct restrictions but also nonrefundable payments in perpetuity. Manufacturers joining the agreement as Subsequent Participating Manufacturers — those manufacturers who were not sued for wrongdoing — while not required to make the same payments as the original participating manufacturers, nevertheless agree to be bound by conduct restrictions. In contrast, nonparticipating manufacturers are subject to no conduct restrictions, and their payments in escrow last for only 25 years. In addition, these manufacturers receive interest on the funds while they are held in escrow, and the principal is fully refundable if the money is not needed to pay a judgment in a tobacco-related lawsuit. Thus, the refundability of the payments is directly related to the nonparticipating manufacturers' future liability for tobacco-related losses.

Thus, the distinctions between manufacturers signing the Master Settlement Agreement and manufacturers not signing are rationally related to their status *vel non* as defendants, their willingness to agree to conduct limitations, and Virginia's need to ensure a source of recovery for all future tobacco-smoking related healthcare costs. All manufacturers thus bear responsibility in differing manners and degrees for limiting the State's future liability for these costs. Those manufacturers who have not admitted to any wrongdoing and who do not wish to limit their future conduct retain the ability to manufacture and market their product in the manner they pursued before, but they essentially provide a surety bond against future liability for tobacco-smoking related healthcare costs.

Appendix A

Under the rational basis review applicable here, we conclude that Virginia's qualifying statute is constitutional. "States are accorded wide latitude in the regulation of their local economies under their police powers, and rational distinctions may be made with substantially less than mathematical exactitude." *Dukes*, 427 U.S. at 303; *see also Kimel v. Florida Bd. of Regents*, 528 U.S. 62, 83 (2000) (holding that, under rational basis review, the Equal Protection Clause does not require States "to match age distinctions and the legitimate interests they serve with razorlike precision"). Even though the tobacco manufacturers are treated differently, the differences in treatment are related to their different circumstances, allowing the State to accomplish its legitimate purposes. "[W]e will not overturn such a statute unless the varying treatment of different groups or persons is so unrelated to the achievement of any combination of legitimate purpose that we can only conclude that the legislature's actions were irrational." *Vance v. Bradley*, 440 U.S. 93, 97 (1979). This deference that we give Virginia's legislative decisions recognizes that "[e]vils in the same field may be of different dimensions and proportions, requiring different remedies. Or so the legislature may think. Or the reform may take one step at a time, addressing itself to the phase of the problem which seems most acute to the legislative mind." *Lee Optical*, 348 U.S. at 489 (internal citations omitted).

Star Scientific acknowledges that providing a source of recovery for the possible harm caused to the State treasury by cigarettes is a legitimate state purpose. It argues, however, that the distinction in Virginia's qualifying statute between manufacturers who signed the Master Settlement Agreement

and those who did not is not rationally related to this purpose or any other legitimate State purpose. It gives several examples.

First, Star Scientific argues that nonparticipating manufacturers are actually treated more harshly under the qualifying statute than are participating manufacturers because nonparticipating manufacturers are required to pay more money and do more to assure against becoming judgment proof in the future than are participating manufacturers. It points to the fact that Subsequent Participating Manufacturers who signed the Master Settlement Agreement within 90 days are not obligated to pay any damages as long as their market share stays within specified bounds. On the other hand, Star Scientific, as a nonparticipating manufacturer, is obligated to pay a fixed amount for each cigarette sold in Virginia regardless of its market position there.

Similarly, Star Scientific notes that the payments made by nonparticipating members under the qualifying statute greatly exceed the equivalent payments made by participating manufacturers to cover future liability. It explains that while all of the payments made by nonparticipating manufacturers under the qualifying statute are used to pay for future harms caused to the Commonwealth, only 5% of the payments made by participating manufacturers go to addressing future harms. To support this assertion, Star Scientific refers to the consent decree entered in Virginia's lawsuit against the major manufacturers, which provides that Virginia has determined that 5% of the payments required under the Master Settlement Agreement "shall be apportioned and deemed attributed to the monetary payment" sought in its complaint.

Appendix A

Star Scientific's arguments demonstrate that Virginia's qualifying statute does not treat nonparticipating manufacturers the same as it does manufacturers who subscribed to the Master Settlement Agreement. But the fact that manufacturers in different circumstances are not treated the same does not mean that the distinctions are irrational or so unrelated to a legitimate purpose that they must be struck down under the Equal Protection Clause. Indeed, the distinctions made by Virginia are rational. Virginia initially made an assessment of those manufacturers who contributed most to its healthcare costs from cigarette smoking, and it sued those manufacturers. Star Scientific was not one of those accused by the Commonwealth and, therefore, was not named a defendant in the litigation. That litigation was resolved against the major manufacturers by the Master Settlement Agreement, under which the manufacturers agreed not only to make payments and pay attorneys fees but also to restrict their conduct. They agreed to limit their advertising and marketing of cigarettes, to limit their lobbying efforts, to disband their industrial associations, and to alter their research policies. These agreements are not insignificant and, indeed, such restrictions might not be enforceable as involuntary governmental bans. Moreover, the payments made to the Commonwealth by the participating manufacturers are not refundable, nor do the manufacturers receive interest on their payments.

The nonparticipating manufacturers, on the other hand, are not required to limit their conduct. Their payments are refundable and earn interest. In addition, they are not required to pay the Commonwealth's attorneys fees.

In short, the distinction between participating manufacturers and nonparticipating manufacturers is rationally related to Virginia's efforts to redress alleged wrongdoing and, at the same time, to assure a future source for covering the costs of cigarette smoking from all tobacco manufacturers.

While the Master Settlement Agreement resolved the litigation between Virginia and the major tobacco manufacturers — those determined by the Commonwealth to be principally responsible for its losses — it also provided an incentive to other manufacturers to participate in the limitations on conduct that the Commonwealth felt were beneficial to it and the citizens of Virginia. Thus, every other manufacturer not sued by the Commonwealth was invited to join the Master Settlement Agreement as a "Subsequent Participating Manufacturer." Such Subsequent Participating Manufacturers were not required to make payments but agreed to limit their conduct. Star Scientific was free to join the Master Settlement Agreement as a Subsequent Participating Manufacturer if it concluded that this would have been a better deal for it, but, apparently for business reasons, it elected not to participate in that capacity.

Also, the fact that Star Scientific may end up paying relatively more toward future healthcare costs than participating manufacturers is directly related to Star Scientific's future liability, which may be higher than that of participating manufacturers because it is not bound by any conduct restrictions. If its liability is not higher, it will receive its escrow payments back, with interest.

In sum, we conclude that the distinctions drawn in Virginia's qualifying statute between tobacco manufacturers participating in the Master Settlement Agreement and those not participating are rationally related to the State's purpose of ensuring a source of recovery from all cigarette manufacturers who are held liable for smoking-related healthcare costs. The Commonwealth's decision to require nonparticipating manufacturers to place funds in an escrow account is not "invidious discrimination" or a "wholly arbitrary act." *Dukes*, 427 U.S. at 303-04. Rather, it is a rational system for assessing tobacco manufacturers for the costs of cigarette smoking as well as regulating their conduct to the extent that they were sued and agreed to resolve that suit through settlement. We therefore conclude that the qualifying statute does not violate the Equal Protection Clause.

IV

Star Scientific contends that Virginia's qualifying statute also violates the Commerce Clause, which gives Congress the power "[t]o regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes." U.S. Const. art. I, § 8, cl. 3. This argument focuses on the aspect of the qualifying statute that assesses an escrow payment amount on each cigarette sold by nonparticipating tobacco manufacturers "within the Commonwealth, *whether directly or through a distributor*, retailer or similar intermediary or intermediaries." Va.Code Ann. § 3.1-336.2.A (emphasis added); *see also id.* § 3.1-336.1 (defining cigarette "units sold" as those sold in the Commonwealth "whether directly or through a distributor, retailer or similar intermediary or intermediaries"). More particularly, Star Scientific argues

that the statute requires it to make payments on cigarettes sold by it to independent distributors in other states if the cigarettes are later sold into Virginia. It maintains that, in this manner, the qualifying statute regulates transactions beyond the Commonwealth's borders and excessively burdens interstate commerce.

In response, Virginia maintains that its qualifying statutes regulate only the sale of cigarettes *in Virginia.* It contends that any incidental burden placed on interstate commerce by operation of the statute is outweighed by Virginia's strong interest in assuring its ability to recover the costs of tobacco use imposed on it by cigarette manufacturers.

The constitutional grant of authority to Congress to regulate interstate commerce "has long been understood, as well, to provide 'protection from state legislation inimical to the national commerce [even] where Congress has not acted.' " *Barclays Bank PLC v. Franchise Tax Bd. of Cal.*, 512 U.S. 298, 310 (1994) (quoting *Southern Pac. Co. v. Arizona ex rel. Sullivan*, 325 U.S. 761, 769 (1945)). This "negative command, known as the dormant Commerce Clause," prohibits States from legislating in ways that impede the flow of interstate commerce. *Oklahoma Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175, 179 (1995). The dormant Commerce Clause's limitation on State power, however, "is by no means absolute. In the absence of conflicting federal legislation the States retain authority under their general police powers to regulate matters of 'legitimate local concern,' even though interstate commerce may be affected." *Lewis v. BT Investment Mgrs., Inc.*, 447 U.S. 27, 36 (1980).

Appendix A

To determine whether a State statute violates the dormant Commerce Clause, we conduct a two-tiered analysis. *Brown-Forman Distillers Corp. v. New York State Liquor Auth.*, 476 U.S. 573, 578-79 (1986); *Environmental Technology Council v. Sierra Club*, 98 F.3d 774, 785 (4th Cir. 1996). "When a state statute directly regulates or discriminates against interstate commerce, or when its effect is to favor in-state economic interests over out-of-state interests," the statute is generally struck down "without further inquiry." *Brown-Forman*, 476 U.S. at 579. Thus, for State statutes that discriminate against interstate commerce, we apply "a virtually *per se* rule of invalidity." *Philadelphia v. New Jersey*, 437 U.S. 617, 624 (1978); *see also Wyoming v. Oklahoma*, 502 U.S. 437, 454-55 (1992). When, however, a statute does not discriminate against interstate commerce but rather "regulates evenhandedly and only indirectly affects interstate commerce," we conduct a fuller analysis — the second tier — involving a balancing test. *See Environmental Technology Council*, 98 F.3d 785; *see also Brown-Forman*, 476 U.S. at 579. In conducting this second-tier analysis, we look to "whether the State's interest is legitimate and whether the burden on interstate commerce clearly exceeds the local benefits." *Brown-Forman*, 476 U.S. at 579 (citing *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970)).

Star Scientific argues first that the qualifying statute is invalid *per se* because it directly regulates commerce occurring wholly outside of Virginia's boundaries. It maintains that "a State violates the Commerce Clause if it attempts to regulate aspects of the stream of commerce that occur upstream, outside the State's borders." It correctly notes that a State may not regulate commerce occurring wholly outside

of its borders. *See Edgar v. MITE Corp.*, 457 U.S. 624, 642-43 (1982) (noting that "[t]he Commerce Clause . . . precludes the application of a state statute to commerce that takes place wholly outside of the State's borders, whether or not the commerce has effects within the State"); *Brown-Forman*, 476 U.S. at 582-83; *Healy v. Beer Inst.*, 491 U.S. 324, 335-36 (1989). Nor may a State pass laws that have "the 'practical effect' of regulating commerce occurring wholly outside the State's borders." *Healy*, 491 U.S. at 332. This proposition is based on the common sense conclusion that "a statute that directly controls commerce occurring wholly outside the boundaries of a State exceeds the inherent limits of the enacting State's authority," regardless of the State's legislative intent. *Healy*, 491 U.S. at 336. Star Scientific maintains that Virginia's qualifying statute is analogous to the statutes held unconstitutional in *Brown-Forman* and *Healy*.

In *Brown-Forman*, the Supreme Court struck down a provision of the New York Alcoholic Beverage Control Law that required liquor distillers to affirm that their prices were no higher than the lowest price at which the same product would be sold in any other state during the month. 476 U.S. at 575-76. The Court found that, while the law was addressed only to the sale of liquor in New York, "the 'practical effect' of the law [was] to control liquor prices in other States" because "[o]nce a distiller has posted prices in New York, it is not free to change its prices elsewhere in the United States during the relevant month." *Id.* at 582-83. Thus, the Court found the law invalid because "[f]orcing a merchant to seek regulatory approval in one State before undertaking a transaction in another directly regulates interstate commerce." *Id.* at 582.

In the same vein, the Court in *Healy* struck down the Connecticut Liquor Control Act which required out-of-state beer shippers to affirm that the prices at which their products were sold to Connecticut wholesalers were no higher than the prices at which those same products were sold in bordering states. 491 U.S. at 326-27. The Court held the statute unconstitutional because it had the practical effect of controlling liquor prices in other States and interfered with the regulatory schemes in those States. *Id.* at 338-39.

Virginia's qualifying statute, however, rather than aiming at or reacting to commerce outside of Virginia, specifically limits its applicability to the sale of cigarettes "within the Commonwealth." Va.Code Ann. § 3.1-336.2.A; *see also id.* § 3.1-336.1 (defining "units sold" as "individual cigarettes sold in the Commonwealth"). Thus, rather than regulate "upstream transactions" outside of the State, the Virginia qualifying statute imposes a fee only for cigarettes actually sold within the State. It has no effect on transactions undertaken by out-of-state distributors in other States.

To the extent that the statute may affect the prices charged by out-of-state distributors, the effect is applicable only to prices charged on cigarettes sold within Virginia. The statute does not insist on price parity with cigarettes sold outside of the State. The statute therefore does not have the "practical effect" of controlling prices or transactions occurring wholly outside of the boundaries of Virginia, as was the case in *Brown-Forman* and *Healy.* Thus, the rule of *per se* invalidity does not apply to the qualifying statute.

Star Scientific argues that in any event, Virginia's qualifying statute fails the balancing test applicable to State

economic regulations that indirectly affect interstate commerce. It asserts that the burden that the qualifying statute places on interstate commerce clearly exceeds its local benefits.

The balancing test applicable to nondiscriminatory legislation affecting interstate commerce was set out in *Pike*, 397 U.S. at 142:

> Where the statute regulates even-handedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits. If a legitimate local purpose is found, then the question becomes one of degree. And the extent of the burden that will be tolerated will of course depend on the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate activities.

(internal citation omitted). To apply this *Pike* balancing test, we consider (1) the nature of the local benefits advanced by the statute; (2) the burden placed on interstate commerce by the statute; and (3) whether the burden is "clearly excessive" when weighed against these local benefits. *Id.*

As we discussed in Parts II and III, above, Virginia's qualifying statute serves the legitimate state interest of ensuring that Virginia has a source of recovery for future smoking-related healthcare costs attributable to tobacco manufacturers who have not subscribed to the Master

Settlement Agreement and who, therefore, are not already compensating the Commonwealth for these healthcare costs. Thus, the putative local benefits are both legitimate and important. We also conclude that the burden of the State's economic regulation on interstate commerce is minimal.

Star Scientific argues, however, that because the escrow payments are imposed on cigarettes sold not only by it, but also by its distributors, even when the distributors purchased the cigarettes outside of the State, Star Scientific is required to "police interstate sales or channel those sales into contractual forms that may be more burdensome to commerce." Star Scientific is, however, overstating its burden. As Virginia points out, distributors in Virginia are already required to record the number of cigarettes they stamp with the Virginia excise stamp and report that information to the Commonwealth. *See* Va.Code Ann. § 58.1-1000 *et seq.* Because distributors already have to keep track of this information, any additional burden caused by requiring manufacturers to obtain this information from the distributors is minimal.

Given the important State interest advanced by the qualifying statute and the minimal burden placed on interstate commerce by its operation, we conclude that the burden on interstate commerce is not "clearly excessive" when compared to the putative local benefits. *See Pike*, 397 U.S. at 142. Thus, we agree with district court that the qualifying statute does not violate the Commerce Clause.

V

Finally, Star Scientific challenges the Master Settlement Agreement itself, contending that it violates the Compact Clause of Article 1, § 10, of the Constitution, which provides that "no State shall, without the consent of Congress, . . . enter into any Agreement or Compact with another State." U.S. Const. art. I, § 10, cl. 3. Star Scientific asserts that the Master Settlement Agreement is in fact an interstate compact and that, because it has not been approved by Congress, the Agreement, as well as the qualifying statutes enacted pursuant to it, are invalid.

Virginia contends that Star Scientific lacks standing to challenge the Master Settlement Agreement, a settlement to which it is not a party. It argues that because invalidating the Master Settlement Agreement would not release Star Scientific from its obligations under the qualifying statute, the purported injury that Star Scientific claims from having to pay into the escrow fund under the qualifying statute is not redressable by its challenge to the Master Settlement Agreement. On the merits, Virginia argues that the Compact Clause is, in any event, not applicable to the Master Settlement Agreement because the agreement does not enhance the political power of Virginia or any other State in a way that encroaches upon the supremacy of the United States. In addition, Virginia asserts that Congress has implicitly, if not expressly, provided any consent that might be needed. *See Cuyler v. Adams*, 449 U.S. 433, 441 (1981) (recognizing implied consent given in a statute enacted prior to the formation of an interstate compact); *Virginia v. Tennessee*, 148 U.S. 503, 521-22 (1893) (recognizing implied

consent to a Border Agreement by treating Border as valid for subsequent revenue, electoral, and judicial purposes); *Green v. Biddle*, 21 U.S. (8 Wheat.) 1, 86-87 (1823) (recognizing implied consent given by admitting State into the Union). In support of this argument, Virginia points to Congress' amendment to the Medicaid statute in 1991, in which Congress authorized the States to use Master Settlement Agreement funds "for any expenditures determined appropriate." Specifically, the amendment provided that federal rules governing health overpayments "shall not apply to any amount recovered or paid to a State as part of the comprehensive settlement of November 1998 between manufacturers of tobacco products . . . and State Attorneys General." 42 U.S.C. § 1396b(d)(3)(B)(i-ii) (Supp. V 1999).

The district court agreed with Virginia and did not reach the merits of the Compact Clause argument. We will address both the standing and the merits issues, *seriatim*.

A

Article III of the Constitution limits the jurisdiction of federal courts to actual "cases" or "controversies." U.S. Const. art. III, § 2. Thus, it is a jurisdictional requirement that a person challenging a government action be a party to a live case or controversy. This standing requirement "is an essential and unchanging part of the case-or-controversy requirement of Article III." *Lujan v. Defenders of Wildlife*, 504 U.S. 555, 560 (1992) (citing *Allen v. Wright*, 468 U.S. 737, 751 (1984)). To establish standing, a party must establish, as "the irreducible constitutional minimum," three elements: (1) that it has suffered

an injury in fact that is both concrete and particularized and "actual or imminent, not conjectural or hypothetical"; (2) that there is a causal connection between the injury and the conduct complained of, i.e. the injury is "fairly traceable" to the challenged action; and (3) that it is "likely . . . that the injury will be redressed by a favorable decision." *Id.* at 560-61 (internal quotation marks and citations omitted); *Burke v. City of Charleston*, 139 F.3d 401, 405 (4th Cir. 1998).

In this case, Star Scientific contends that its payments into escrow pursuant to Virginia's qualifying statute impose an actual and concrete injury that is "fairly traceable" to the Master Settlement Agreement because the Master Settlement Agreement coerced the Commonwealth to enact the qualifying statute that causes Star Scientific's injury. Accordingly, it argues, its injury will be redressed by a favorable decision invalidating the Master Settlement Agreement.

Virginia contends, however, that instead of requiring the States to enact escrow statutes, the Master Settlement Agreement only *encourages* the enactment of such statutes. It asserts that every settling State retains "full freedom *not* to pass the 'contemplated' law, and a State that chooses not to do so remains a full party to the Master Settlement Agreement." If a state does not enact a qualifying statute, the tobacco companies remain released from liability for past and future claims and the States receive the benefit of the conduct restrictions imposed on the tobacco companies by the agreement. In addition, in certain peculiar circumstances a State that fails to enact a qualifying statute might still receive some payments.

Appendix A

Star Scientific acknowledges that there is not a complete dependency between the Master Settlement Agreement and the qualifying statute, but it maintains it has standing to challenge the Master Settlement Agreement because the agreement is powerfully coercive. The Master Settlement Agreement, it argues, "provides enormous financial incentives for the Commonwealth to adopt the Qualifying Statute and imposes large penalties if the statute is repealed." We agree with Star Scientific.

In *Bennett v. Spear*, 520 U.S. 154 (1997), the Supreme Court was presented with a similar situation and found sufficient coercion to form the basis for standing. In that case, the plaintiffs challenged a Biological Opinion issued by the Fish and Wildlife Service, claiming that the allocation of water required by the Opinion affected the amount of water available to the plaintiffs. *Id.* at 167-68. The government argued that the harm asserted by the plaintiffs was not caused by the Biological Opinion because the Bureau of Reclamation was an intervening actor determining whether to implement the requirements of the Opinion. *Id.* at 168. The Supreme Court rejected this argument and concluded that while the Bureau was "technically free to disregard the Biological Opinion . . . it [did] so at its own peril" and faced substantial penalties if it ignored the opinion. *Id.* at 170. In these circumstances, the Court concluded that the plaintiffs' injuries were fairly traceable to the Biological Opinion despite the intervening action of the Bureau of Reclamation.

Similarly, the Master Settlement Agreement, while not technically *requiring* Virginia to enact a qualifying statute, nevertheless imposes a powerful incentive for it to do so. Virginia would suffer large penalties if it failed to enact the

statute. For example, if the participating manufacturers were to lose market share and their loss was attributable to their payments under the Master Settlement Agreement and to the nonparticipating manufacturers' freedom from such payments, the "Firm" (the administrative body created under the Master Settlement Agreement) could determine that this loss was caused by Virginia's failure to enact a qualifying statute and, on that basis, decrease Virginia's payments from the manufacturers under the agreement. Because Virginia could face a substantial financial burden if it were not to enact a qualifying statute, the Master Settlement Agreement is coercive in requiring the states to pass such a statute. We conclude that this coercion is significant and that, therefore, Star Scientific's injuries may be fairly traceable to the requirements of the Master Settlement Agreement. Accordingly, we conclude that Star Scientific has standing to challenge the Master Settlement Agreement under the Compact Clause.

B

The Compact Clause does not require congressional approval of every agreement between or among States. Instead, the Supreme Court has held that "the proper balance between federal and state power with respect to compacts and agreements among states" is maintained by limiting application of the Compact Clause to agreements that are "directed to the formation of any combination tending to the increase of political power in the States, which may encroach upon or interfere with the just supremacy of the United States." *Virginia v. Tennessee*, 148 U.S. 503, 519 (1893); *see also Northeast Bancorp., Inc. v. Board of Governors of the Fed. Res. Sys.*, 472 U.S. 159, 175-76 (1985); *United States Steel*

Corp. v. Multistate Tax Comm'n, 434 U.S. 452, 471 (1978); *New Hampshire v. Maine*, 426 U.S. 363, 369 (1975).

The Master Settlement Agreement principally operates vertically between each State and the signatory tobacco companies, providing releases from liability to the tobacco companies in exchange for conduct restrictions and payments. But in administering the amount of payments under the Master Settlement Agreement and their relationship to the escrow accounts established under qualifying statutes, the Master Settlement Agreement creates an administrative body — the Firm, consisting of economic consultants — to determine compliance with the Master Settlement Agreement. To the extent that the States agree on the creation of this single administrative body and its functioning, there is a horizontal aspect to the Master Settlement Agreement that establishes a compact among the States, implicating the Compact Clause.

Although the Master Settlement Agreement implicates the Compact Clause, we see no reason to conclude that it encroaches on federal power. In *Multistate Tax Commission*, the Supreme Court upheld a compact resulting in reciprocal State legislation and establishing an administrative body to coordinate State taxation of certain entities. 434 U.S. at 472-73. The Court noted that the compact might result in an increase in bargaining power of the member States with respect to the corporations subject to their taxing jurisdictions, but it found such an increase in power to be acceptable because "the test is whether the Compact enhances state power *quoad* the National Government." *Id.* at 473. Similarly, the Master Settlement Agreement may result in an increase in bargaining power of the States vis-a-vis the tobacco manufacturers,

but this increase in power does not interfere with federal supremacy because the Master Settlement Agreement "does not purport to authorize the member States to exercise any powers they could not exercise in its absence." *Multi-State Tax Comm'n*, 434 U.S. at 473.

In addition, the Master Settlement Agreement does not derogate from the power of the federal government to regulate tobacco. Sections X and XVIII(a) of the agreement specifically anticipate that Congress may, in the future, pass laws regulating tobacco and provides for adjustments of the Master Settlement Agreement's terms if that occurs. Similarly, Star Scientific's argument that the Master Settlement Agreement derogates from the federal bankruptcy policy is without merit. Again, Section XVIII(w)(1)(c) of the Master Settlement Agreement, dealing with bankruptcy, specifically states that the provision is only enforceable if consistent with the Bankruptcy Code.

In sum, we conclude that the Master Settlement Agreement does not increase the power of the States at the expense of federal supremacy and that, therefore, it is not an interstate compact requiring congressional approval under the Compact Clause.

VI

Today, it is generally recognized that "tobacco use, particularly among children and adolescents, poses perhaps the single most significant threat to public health in the United States." *Lorillard Tobacco Co. v. Reilly*, 121 S.Ct. 2404, 2430 (2001) (internal quotation marks and citation omitted). The costs attributable to this major public health issue

are borne by various constituencies, including the States. Through years of lawsuits and settlement agreements, the States and the major tobacco companies have finally reached an agreement broadly addressing the public health threat, and this agreement, if it is to be effective, necessarily has implications beyond the parties, reaching nonsettling tobacco companies, such as Star Scientific.

Regardless of Star Scientific's innocence in any alleged wrongdoing — allegations that made the Master Settlement Agreement with the major manufacturers possible — Star Scientific remains a tobacco company whose products continue to threaten the public health. For that reason alone, its inclusion in a legislative scheme to establish financial responsibility for this public health issue is not inherently irrational. Indeed, it falls squarely within the States' police power to promote the public health, safety, welfare, and morals of the State. *See Berman v. Parker*, 348 U.S. 26, 32 (1954).

Star Scientific might rightly claim innocence as to past wrongdoing and might even be justified in claiming credit for its efforts to educate would-be smokers about the adverse effects of smoking and for its efforts to reduce, through research, cancer-causing toxins in cigarettes. But it cannot deny that it is a cigarette manufacturer whose products will continue to threaten the public health. While it does not suggest any such denial, it nevertheless persists in its particular claim that the entire arrangement created by the Master Settlement Agreement and qualifying statutes effects an improper and unjust transfer of large amounts of money from cigarette manufacturers to settling States while openly protecting the profits of the alleged wrongdoers. It characterizes this claim as follows:

> Such naked rent-seeking legislation to protect the position of politically favored actors usually comes cloaked in the sheep's clothing of some legitimate state purpose to which the regulation bears a plausible relation. And in the dim light of rational basis review, this often-transparent disguise is good enough.
>
> "But this wolf comes as a wolf," *Morrison v. Olson*, 487 U.S. 654, 699 (1988) (Scalia, J. dissenting), because the MSA states that the "Qualifying Statute" must "effectively and fully neutralize [ ] the cost disadvantages that the Participating Manufacturers experience vis-a-vis Non-Participating Manufacturers within such Settling State as a result of the provisions of this Agreement." Whether viewed under the lens of due process or equal protection, that purpose is constitutionally impermissible. The Constitution simply does not allow a State to protect its judgment creditors by imposing financial burdens on their competitors who have not been found liable to the State.

This viewpoint, however, fails to account fully for the larger continuing problem to which Star Scientific necessarily and unquestionably contributes. It also fails to recognize the justifications for the meaningful distinctions in the treatment of the major tobacco manufacturers, who were targeted with alleged wrongdoing, and the smaller tobacco companies, such as Star Scientific, who were not, but yet still threatened the public health.

Appendix A

Not only are the major tobacco manufacturers' payments of over $200 billion irrevocable and without interest, their conduct in associating with each other, in advertising, in marketing, and in researching tobacco products is permanently restricted. These manufacturers also have agreed to reimburse the States for their attorneys fees. Even though nonparticipating tobacco manufacturers, such as Star Scientific, are required to pay comparable amounts into an escrow fund, such payments earn interest for the manufacturer, and the principal is returned after 25 years if the company does not incur tobacco-related liability. If Star Scientific had found these differences in treatment unfair, it was free to participate in the Master Settlement Agreement as a Subsequent Participating Manufacturer. While this choice may not have been an ideal one for Star Scientific and either option would surely burden its operations, the effect of either option is no different than the effect of a tax that might have been imposed to pay for the public health costs. When viewed in this larger context, Star Scientific's claim of irrationality and impermissible discrimination by Virginia cannot be sustained.

For the reasons we have given, we reject Star Scientific's constitutional challenge to the qualifying statute based on the Due Process, Equal Protection, and Commerce Clauses of the United States Constitution, and we likewise reject its challenge to the Master Settlement Agreement under the Compact Clause. The judgment of the district court is accordingly

AFFIRMED.

APPENDIX B — MEMORANDUM OPINION AND ORDER OF THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF VIRGINIA, RICHMOND DIVISION DATED AND FILED MARCH 26, 2001

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
RICHMOND DIVISION

Civil Action Number 3:00CV835

STAR SCIENTIFIC, INC.

Plaintiff.

v.

MARK EARLEY, in his official capacity as the Attorney General of the Commonwealth of Virginia

Defendant.

MEMORANDUM OPINION

THIS MATTER comes before the Court on defendant Earley's motion to dismiss Star Scientific's First Amended Complaint for lack of jurisdiction and failure to state a claim upon which relieve can be granted, pursuant to Rules 12(b)(1) and (6) of the Federal Rules of Civil Procedure. For the reasons stated in the following memorandum, the defendant's motion is GRANTED. Star Scientific's challenges to the Master Settlement Agreement ("MSA") are DISMISSED for

lack of subject matter jurisdiction; and their challenges to Va. Code Ann. §§ 3.1-336.1-2 are DISMISSED for failure to state a claim upon which relief can be granted.

I.

This matter arises out of the lawsuits brought by various States' Attorneys General against the four major tobacco companies, Phillip Morris, RJ Reynolds, Brown & Williamson, and Lorilland ("Big Four"), in order to recover expenditures made through the states' Medicaid and other health and welfare programs to treat cigarette-related disease. In the early 1990s, various class action suits were filed on behalf of plaintiff smokers to recover damages for tobacco-related illness. *See First Amended Complaint*, ¶ 42. In 1994, Mississippi, Minnesota, West Virginia and Massachusetts filed actions in their respective state courts seeking reimbursement for health care expenditures made on behalf of citizens suffering from tobacco-related disease. Other states quickly initiated suits of their own. *See First Amended Complaint*, ¶ 42.

In June of 1997, the Big Four and several attorneys general proposed a settlement of not only the states' claims, but also claims that had been or might be brought in various class actions. *See First Amended Complaint*, ¶ 43. The original framework, called the Tobacco Resolution, implicated federal interests (creating FDA oversight and regulation of tobacco as well as immunity from private, state and federal claims), and it required federal legislation to implement it. *See First Amended Complaint*, ¶ 43. Such legislation was introduced, but died in Committee in

June 1998. *See First Amended Complaint*, ¶¶ 45-47. In the interim, four states ("previously settling states") reached individual settlements with the Big Four; calling for the payment of $38 billion over 25 years. *See PTI, Inc. v. Phillip Morris, Inc.*, 100 F. Supp.2d 1179, 1185, n. 2 (C.D. Cal. 2000) (noting the settlements of Florida, Minnesota, Mississippi, and Texas prior to the date of the MSA).

After it became apparent that federal legislative action was not forthcoming, the remaining combatants developed the MSA on November 23, 1998 - an agreement between the Big Four, the Commonwealth, 45 other states, the District of Columbia, Puerto Rico, and four U.S. territories.[1] *See First Amended Complaint*, ¶¶ 48-54. The MSA contains strict prohibitions against certain advertising and lobbying activities of the participating manufacturers ("PMs"), as well a system to direct payments to the Settling States into perpetuity. Some specific provisions are:

Manufactures Agreed:

- not to target youth in advertising, promotion and marketing of cigarettes;
- to cease using cartoon characters to promote cigarettes;
- to eliminate the use of billboards and outdoor advertising;
- to limit sponsorship of sporting and other promotional events;
- to donate $1.5 billion to form a foundation to implement public service announcements to emphasize the dangers of smoking; and

1. The states participating in the MSA will be called Settling States.

- to make certain payments to the Settling States into perpetuity for the states to implement various public health initiatives to combat tobacco use in their respective states.[2]

States Agreed:

- to grant the Big Four immunity from liability; and
- to implement Qualifying Legislation to enforce the terms of the MSA.

See MSA §§ III, IV, and V. It is projected that the Big Four will pay the Settling States over $200 billion through 2005. Of that sum, the Commonwealth receives approximately 2.05%, or $4.1 billion through 2005. It has received approximately $212.1 million to date. *See Mot. to Dis.* at 6.

There is also a second group of manufacturers participating in the MSA. This group of subsequent participating manufacturers ("SPMs"), are those manufactures that signed the MSA during the sixty days immediately following its execution date. *See First Amended Complaint*, ¶ 87; *MSA* § IX(i). The SPMs are not required to make any payments to the Settling States as long as their market share does not increase more than 25%. They are, however, bound by the same strict conduct provisions of the MSA that bind the Big Four. *See First Amended Complaint*, ¶ 87; *MSA* §§ IX(d)(2), (i).

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2. These payments are subject to numerous adjustments based on inflation and sales volume, as well as other factors.

Appendix B

Those companies not wishing to participate in the MSA, or Nonparticipating Manufacturers ("NPMs"), have no obligations under the MSA and the Settling States reserve all rights to pursue them for damages. *See, generally*, MSA §§ II, III, IX, XII, XVIII(t). However, the MSA requires that each Settling State enact legislation that would require NPMs to place certain funds in escrow "that effectively and fully neutralizes the cost disadvantages that the Participating Manufacturers experience vis-a-vis Non-Participating Manufacturers within such Settling State as a result of the provision of this Agreement." *MSA* § IX(E). Each Settling State agreed that the Qualifying Statute would closely follow the model provided in Exhibit T of the MSA. Failure to enact the Qualifying Statute would result in the Settling States losing the MSA settlement funds. *See MSA* § IX(E).

The Commonwealth codified the Qualifying Statute as Va. Code Ann. § 3.1-336.2. The Statute requires that NPMs make annual payments to an escrow account, which will be held for 25 years, against which the Commonwealth may bring any future claims. *See* Va. Code Ann. §§ 3.1-336.2(A)(2) and (B)(1).

The plaintiff, Star Scientific, Inc., is an NPM under the MSA. It has been in the tobacco manufacturing business since 1990. *See First Amended Complaint*, ¶ 21. After spending its first four years of existence as a contract manufacturer for other companies, it began selling its own brand of discount cigarettes, using Virginia flue-cured tobacco, in 1994. *See First Amended Complaint*, ¶ 21. Star Scientific has a contract with Brown & Williamson to manufacture a

portion of their cigarette brands in Macon, Georgia, which are then shipped to distributors all around the United States. *See First Amended Complaint*, ¶ 22.

In recent years, Star Scientific has embarked upon developing new curing technologies that help reduce the levels of certain carcinogen TSNA's in tobacco, as well as other techniques directed at producing a "safer" cigarette. *See First Amended Complaint*, ¶¶ 16-19. Along with developing new technologies, Star Scientific has continually provided extensive disclosure regarding the dangers of cigarette use with its products and lobbied to have tobacco products regulated by the FDA. *See First Amended Complaint*, ¶¶ 18, 29. On October 2, 2000, Star Scientific introduced a cigarette made wholly from tobacco cured with its patented technique. It also plans to introduce smokeless tobacco products containing low-TSNA tobacco later this year. *See First Amended Complaint*, ¶ 28.

It is undisputed that Star Scientific was not a party to the lawsuit brought by the Commonwealth against the Big Four, nor has it been a party to any of the suits leading to the MSA. Star Scientific filed suit in this Court on December 15, 2000 seeking a Declaratory Judgment and a preliminary and permanent injunction against the MSA, Va Code § 3.1-336.1-2, as well as any other relief that the Court deems appropriate.

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II.

A court may only grant a motion to dismiss when "it appears certain that the plaintiff can prove no set of facts which would support its claim and would entitle it to relief." *Mylan Laboratories, Inc. v. Matkari*, 7 F.3d 1130, 1134 (4th Cir. 1993). The allegations in the complaint must be viewed in a light most favorable to the plaintiff, and assuming the allegations to be true. *See Carter v. Arlington Pub. School Sys.*, 82 F. Supp.2d 561, 564 (E.D. Va. 2000). In this case, defendant's motion to dismiss is based on F.R.C.P. 12(b)(1) and 12(b)(6) grounds. On a motion to dismiss pursuant to Rule 12(b)(1), unlike Rule 12(b)(6), courts may consider evidence outside of the complaint to resolve factual disputes concerning jurisdiction without converting the motion into one for summary judgment." *Id.* at 564 (quoting *Williams v. United States*, 50 F.3d 299, 304 (4th Cir. 1995)).

III.

Earley makes the following arguments in favor of the motion to dismiss:

(1) Counts I and II should be dismissed because the Court lacks subject matter jurisdiction to hear them;

(2) Counts III through VI fail to state a claim upon which relief can be granted as a matter of law.

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IV.

Counts I and II of the First Amended Complaint allege that the MSA violates both the Compact Clause and the Commerce Clause of the Constitution of the United States. Earley's first argument in the motion to dismiss is that Star Scientific lacks standing to challenge the MSA. There is no dispute that Star Scientific has standing to challenge the Qualifying Statute, Va Code Ann. §§ 3.1-336.1-2.

One of the fundamental principles of constitutional law is the "cases" or "controversies" requirement for justiciability referred to in Article III. U.S. Const. § Art. III, 2, cl. 1. *See Whitmore v. Arkansas*, 495 U.S. 149, 155, 110 S.Ct. 1717, 1723, 109 L.Ed.2d 135 (1990). The standing doctrine has always been an essential component of the case or controversy requirement for federal jurisdiction. *See Lujan v. Defenders of Wildlife*, 504 U.S. 555, 560, 112 S.Ct. 2130, 2136, 119 L.Ed.2d 351 (1992); *see also Allen v. Wright*, 468 U.S. 737, 751, 104 S.Ct. 3315, 3324-25, 82 L.Ed.2d 556 (1984) (standing a necessary core component of subject matter jurisdiction).

The three basic components of standing are injury, causation, and redressability. In order to have standing in federal court, a federal complainant must demonstrate: (1) he has suffered an actual or threatened injury; (2) a causal connection between the injury complained of and the challenged action; and (3) that the injury can be redressed by a favorable decision. *See Lujan*, 504 U.S. at 560, 112 S.Ct. at 2136; *Valley Forge Christian College v. Americans United for Separation of Church & State*, 454 U.S. 464, 472, 102

S.Ct. 752, 758-59, 70 L.Ed.2d 700 (1982); *Simon v. Eastern Ky. Welfare Rights Org.*, 426 U.S. 26, 41-42, 96 S.Ct. 1917, 1925-26, 48 L.Ed.2d 450 (1976).

In this case, since Star Scientific is the party seeking federal relief, they bear the burden of establishing standing to challenge the MSA. *See FW/PBS. Inc. v. Dallas*, 493 U.S. 215, 231, 110 S.Ct. 596, 607-08, 107 L.Ed.2d 603 (1990). This standing must exist when the original pleading is filed. See *Lujan*, 504 U.S. at 571 n. 4, 112 S.Ct. at 2142 n. 4.

Star Scientific argues that the MSA and the Qualifying Statute (codified as Va Code Ann. § 3.1-336.1-2), work in conjunction to create a price-fixing and market allocation scheme which, if various state actors were not involved, would violate the antitrust laws.[3] *See First Amended Complaint*, ¶ 8. Star Scientific argues further that since the MSA requires that the Settling States implement Qualifying Statutes which require NPMs to surrender large sums of money to be placed in escrow, it makes it impossible for small manufacturers like themselves to challenge the market share of the Big Four.[4] *See First Amended Complaint*, ¶ 9. Star Scientific had previously invested heavily in research

3. Star Scientific cites a district court in California to support the proposition that the MSA is really a price-fixing scheme. *See PTI, Inc. v. Philip Morris, Inc.*, 100 F.Supp.2d 1179, 1192-97 (C.D. Cal. 2000) (Noerr-Pennington and state action doctrines preclude the court from ruling on antitrust claims).

4. At the time of the MSA's execution, the Big Four controlled 98% of the tobacco market in contrast to Star Scientific's approximate 1% stake. *See First Amended Complaint*, ¶ 39.

and development of less toxic tobacco products before enactment of Virginia's NPM statute - research which is now imperiled by the escrow requirement. *See First Amended Complaint*, ¶ 38. The NPM statute deprives them of the necessary capital to continue their development of "less harmful" cigarettes, and provide an alternative product to those offered by the Big Four. *See First Amended Complaint*, ¶ 8. They argue that the MSA had the intended effect of "freezing" the national cigarette market, thereby protecting the dominant position of the Big Four in the market. *See First Amended Complaint*, ¶¶ 39, 75.

Third parties, generally speaking, "lack standing to object to a partial settlement agreement unless they can demonstrate they will suffer formal legal prejudice caused by the settlement." *See, e.g., Alumax Mill Prods., Inc. v. Congress Fin. Corp.*, 912 F.2d 996, 1001-02 (8th Cir. 1990); *Quad/Graphics. Inc. v. Fass*, 724 F.2d 1230, 1232-33 (7th Cir. 1983) (noting such a standard properly balances the law's encouragement of voluntary settlements and the court's duty to protect the rights of the parties before it). Examples of "legal prejudice" include the forfeit of a legal cause of action or depriving a party of indemnity or contribution rights. *See Bragg v. Robertson*, 54 F.Supp.2d 653, 664 (S.D. W. Va. 1999) (quoting *Agretti v. ANR Freight Sys., Inc.*, 982 F.2d 242, 247 (7th Cir. 1992)).

While the MSA may present several daunting competitive hurdles to the small tobacco manufacturer, Star Scientific's choice not to participate in the MSA completely relieves them of such challenges. Because Star Scientific is not bound by any of the advertising, promotional,

or lobbying restrictions contained in the MSA, nor are they bound to make any payments to Settling States under the MSA, the company is free to pursue increased market share as it wishes. Star Scientific cannot allege an injury under the MSA that is "concrete and particularized," because it is not bound by its provisions. *See Lujan*, 504 U.S. at 559, 112 S.Ct. at 2136. The document in no way causes Star Scientific to suffer from any legal prejudice. *See Alumax*, 912 F.2d at 1001-02.

Star Scientific is attempting to bootstrap the standing that it has to challenge the NPM statute onto the MSA, by arguing that the MSA controls the Qualifying Statute, which in turn affects Star Scientific. Such a ploy has yet to find support in the applicable case law. *See Perry v. Sheahan*, 222 F.3d 309, 314 (7th Cir. 2000); *Natural Resources Defense Council v. Pena*, 147 F.3d 1012, 1014 (D.C. Cir. 1998); *Wilcox v. FAA*, 119 F.3d 724; 727 (8th Cir. 1997).

Star Scientific has failed its burden to demonstrate that it has suffered from any actual or threatened injury under the MSA, nor could it allege any set of facts that would allow it to do so. The MSA does not apply to the company in any way. Star Scientific has, therefore, failed to demonstrate that it has standing to challenge the MSA. Since Star Scientific lacks standing, the Court is without subject matter jurisdiction to carry the analysis of their claims under the MSA any further. Accordingly, Earley's motion to dismiss counts I and II of the First Amended Complaint, pursuant to Rule 12(b)(1) of the Federal Rules of Civil Procedure, is GRANTED.

Appendix B

V.

The last four counts of the First Amended Complaint challenge Virginia's NPM Statute, Va Code Ann. §§ 3.1-336.1-2, on several constitutional grounds. As discussed *supra*, it is undisputed that Star Scientific has standing to challenge the NPM Statute.

The Virginia NPM statute requires that Star Scientific place in escrow a certain amount of money for each one of its cigarettes sold in Virginia in a given year. *See* Va. Code Ann. § 3.1-336.2(A)(2). This amount ranges from $0.0094241 per cigarette in 1999 to $0.0188482 per cigarette in 2007 and beyond.[5] *See id.* The funds collected are to be held in escrow for twenty-five years, and if not previously released to pay a judgment, are returned to the NPM. *See id.* at (B)(1)-(3). The NPM receives the interest on the funds as earned: *See id.* at (B).

a. Count III - Equal Protection

Count III of the First Amended Complaint alleges that Va. Code Ann. §§ 3.1-336.1-2 results in disparate treatment between NPMs and SPMs that is arbitrary, irrational, and fails to serve a legitimate state purpose. More specifically, Star Scientific alleges that since the "real" purpose of the legislation is explicitly laid out in § IX(d)(2)(E) of the MSA, the statute cannot serve a legitimate state purpose.[6]

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5. There are approximately 20 cigarettes per pack.

6. The specific language in question defines the term "Qualifying Statute" as a settling state's statute, regulation or law, or other "generally applicable rule" that "effectively and fully neutralizes

(Cont'd)

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It is a well established principle of Constitutional Jurisprudence that a classification neither involving fundamental rights nor proceeding along suspect lines will not run afoul of the Equal Protection Clause if there is a rational relationship between the disparity of treatment and some legitimate governmental purpose. *See Heller v. Doe*, 509 U.S. 312, 319-320, 113 S.Ct. 2637, 2641-42, 125 L.Ed.2d 257 (1993). "When local economic regulation is challenged . . . as violating the Equal Protection Clause, this Court consistently defers to legislative determinations as to the desirability of particular statutory discriminations." *New Orleans v. Dukes*, 427 U.S. 297, 303, 96 S.Ct. 2513, 2517, 49 L.Ed.2d 511 (1976) (per curiam). [R]ational-basis review in equal protection analysis "is not a license for courts to judge the wisdom, fairness, or logic of legislative choices." *Id.* (quoting *FCC v. Beach Communications. Inc.*, 508 U.S. 307, 313, 113 S.Ct. 2096, 2100-2101, 124 L.Ed.2d 211 1993)). "Further, a legislature that creates these categories need not 'actually articulate at any time the purpose or rationale supporting its classification.' " *Heller*, 509 U.S. at 320, 113 S.Ct. at 2642 (quoting *Nordlinger v. Hahn*, 505 U.S. 1, 11, 112 S.Ct. 2326, 2331-2332, 120 L.Ed.2d 1 (1992)). Therefore, a classification "must be upheld against equal protection challenge if there is any reasonably conceivable state of facts that could provide a rational basis for the classification." *Beach Communications*, 508 U.S. at 313, 113 S.Ct. at 2101.

(Cont'd)
the cost disadvantages that the Participating Manufacturers experience vis-avis Non-Participating Manufacturers within such Settling State as a result of the provisions of [the MSA]." *MSA* § IX(d)(2)(E).

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Star Scientific is neither a member of a suspect class, nor does Va. Code Ann. §§ 3.1-336.12 implicate any fundamental rights. Star Scientific complains that it is treated differently than the SPMs that operate in the Commonwealth in that SPMs are not required to place any funds in escrow or make payments to the Commonwealth. However, if Star Scientific wanted to enjoy such benefits it had ample opportunity to become an SPM under the MSA. They chose not to do so and cannot now complain that they are deprived of the same benefits that SPMs receive.

The Commonwealth of Virginia, despite not being obligated to do so, has articulated that the purpose of the statute is to ensure that in the event the Commonwealth seeks damages against Star Scientific, or any other NPM, for the costs of treating tobacco-related illness through its Medicaid and welfare programs, there will be assets to provide a source of recovery. Providing a source of recovery for the possible harm caused to the state treasury by a dangerous product surely cannot be said to be an illegitimate purpose. The amount of money that NPMs are required to place in escrow is directly connected to the impact of its tobacco products in the Commonwealth. Without the NPM statute, tobacco manufacturers that are free to participate in the unrestricted marketing and promotion of a product that is unquestionably harmful to the health of the citizens of the Commonwealth would be able to collect profits while inflicting damage that will not manifest for years to come, and possibly leave the Commonwealth holding the bag. The NPM statute is a direct legislative response taken to close off that possibility. Despite all Star Scientific's arguments to

the contrary, it is not for this Court to look beyond this stated purpose and impute any other motives to the legislature. *See New Orleans*, 427 U.S. at 303, 96 S.Ct. at 2517.

This is not to say that Star Scientific's position is not appreciated by the Court. It does seem troubling that a company that has by all accounts taken every step to provide complete disclosure about the harmful nature of its products, and has embarked upon research into methods that it and many others believe will reduce the toxic nature of cigarettes, must now suffer as a result of the bad faith of previous market entrants. Star Scientific has never been accused of the fraudulent, collusive and intentionally dishonest activities of the Big Four, yet is also cast as a "villain." In fact, the company was not even in existence during the bulk of the time that these activities were occurring. Furthermore, the Court does believe that the financial burden on Star Scientific and others like it may hamper efforts to develop new tobacco technologies. However, it is not the role of this Court to "sit as a superlegislature to judge the wisdom or desirability of legislative policy determinations made in areas that neither affect fundamental rights nor proceed along suspect lines." *See id.* Defendant Earley has articulated a rational basis for a classification that pursues a legitimate state purpose. This Court is bound, therefore, to find that Virginia's NPM statute, Va. Code. Ann. § 3-1336.1-2, does not violate equal protection." Defendant Earley's motion to dismiss count III of the First Amended Complaint, pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure is GRANTED.

b. Count IV - Due Process

Count IV of the First Amended Complaint alleges that since the NPM statute's assumption of future liability is wildly speculative at best, the requirement that Star Scientific place such large sums in escrow violates due process. They state that the financial burden imposed by the NPM statute is really an attempt to force Star Scientific to join the MSA, and protect the market share of the Big Four.

The bulk of the analysis applied supra to the equal protection claim control the Court's assessment of Star Scientific's due process claim. Virginia's NPM statute burdens no fundamental rights. "It is 'a classic example of an economic regulation' and is subject only to the minimum scrutiny rational basis test." *Carbon Fuel Company v. USX Corp.*, 100 F.3d 1124, 1137 (4th Cir. 1996); *Duke Power Co. v. Carolina Envtl. Study Group*, 438 U.S. 59, 83-84, 98 S.Ct. 2620, 2635-36, 57 L.Ed.2d 595 (1978); *Board v. Bulala*, 877 F.2d 1191, 1196-97 (4th Cir. 1989). "[T]he burden is on one complaining of a due process violation to establish that the legislature has acted in an arbitrary and irrational way." *Duke Power*, 438 U.S. at 83, 98 S.Ct. at 2636.

Star Scientific simply fails to meet the burden to demonstrate that Va. Code. Ann. § 3.1336.1-2 violates due process. As discussed *supra*, the NPM statute is a rational way to pursue the legitimate purpose of the Commonwealth to provide assets from which to recover in the event that they obtain a judgment against Star Scientific in the future. The fact that Star Scientific's liability is neither certain, nor the amount of damages is not presently ascertainable, does

not make the statute "arbitrary or irrational." Furthermore, while Star Scientific has imputed a host of sinister reasons for the legislative action, it is not the place of this Court to explore such accusations once it has been determined that the legislation is rationally related to a legitimate state purpose. *See Beach Communications*, 508 U.S. at 313, 113 S.Ct. at 2101. Therefore, Earley's motion to dismiss count IV, pursuant to Rule 12(b)(6), is GRANTED:

c. Count V - Commerce Clause

In count V of the First Amended Complaint, Star Scientific argues that Virginia's NPM statute violates the dormant commerce clause because it imposes a crippling financial burden on tobacco manufacturers that have not joined the MSA. Star Scientific argues further that the NPM statute's escrow requirement discourages the development and sale of a less harmful cigarette.

The dormant Commerce Clause is principally implicated by state legislation that interferes "with the maintenance of a national economic union." *Healy v. The Beer Institute, Inc.*, 491 U.S. 324, 335-36, 109 S.Ct. 2491, 2499, 105 L.Ed.2d 275 (1989). This results because the legislation either facially discriminates in favor of local interests, *see City of Philadelphia v. New Jersey*, 437 U.S. 617, 624, 98 S.Ct. 2531, 2535, 57 L.Ed.2d 475 (1978), or, although facially neutral, its practical effect results in direct control of commerce occurring wholly outside the boundaries of the state. *See Beer Institute*, 491 U.S. at 336, 109 S.Ct. at 2499. Even-handed state legislation that places an incidental burden on interstate commerce will pass constitutional muster unless the plaintiff

can show that the burden is excessive in comparison to the local benefits. *See Oregon Waste Systems, Inc. v. Department of Environmental Quality*, 511 U.S. 93, 99, 114 S.Ct. 1345, 1350, 128 L.Ed.2d 13 (1994).

Nothing in Star Scientific's First Amended Complaint can be construed to argue that Va. Code Ann. §§ 3.1-336.1-2 is facially discriminatory. Therefore, the statute can only be found to violate the commerce clause if it either has impermissible extraterritorial effect, or is excessively burdensome.

1. ***Impermissible extraterritorial effect and excessive burden.***

Star Scientific argues that because the NPM statute applies to any and all sales of its cigarettes in Virginia bearing the excise stamp of the Commonwealth, including sales of distributors to whom Star Scientific might have sold the cigarettes in another state, that the statute has impermissible extraterritorial effect. They argue that the burden of this effect on interstate commerce far outweighs the benefits of the statute.

The Supreme Court said in *Kassel v. Consolidated Freightways, Corp.*, 450 U.S. 662, 670, 101 S.Ct. 1309,1316, 67 L.Ed.2d 580 (1981), that "if safety justifications are not illusory, the Court will not second-guess legislative judgment about their importance in comparison with related burdens on interstate commerce. Those who would challenge such bona fide safety regulations must overcome a strong presumption of validity." *Id*; *Bibb v. Navajo Freight Lines,*

Inc., 359 U.S. 520, 524, 79 S.Ct. 962, 964, 3 L.Ed.2d 1003 (1959) (citations omitted). "[T]he incantation of a purpose to promote the public health or safety does not insulate a state law from Commerce Clause attack." *Kassel*, 450 U.S. at 670, 101 S.Ct. at 1316. However, the courts should not use dormant commerce clause analysis to "to second-guess the empirical judgments of lawmakers concerning the utility of legislation." *CTS Corp. v. Dynamic Corp. of Am.*, 481 U.S. 69, 92, 107 S.Ct. 1637, 1651, 95 L.Ed.2d 67 (1987) (citation omitted). In these cases, the Supreme Court was principally concerned with whether or not the health and safety legislation in question was an attempt by one state to shunt the costs of certain activity to other states while enuring the benefits to themselves. Such is not the case at bar.

In this case, the escrow statute requires NPMs to pay approximately $0.20 per pack of its product sold in Virginia. *See* Va. Code Ann. § 3.1-336.2(A)(2). The Commonwealth has articulated that the statute is meant to provide recovery for the impact of what is, by Star Scientific's own admission, a dangerous product, and to protect the health of the citizens of Virginia. While it is true that some of the cigarettes in question may have been brought into Virginia by outside distributors, the legislature has determined that Star Scientific must still bear the responsibility for the future impact of *its own product* in the Commonwealth. The fact that the cigarettes may pass through several hands in the stream of commerce does not change the fact the Star Scientific is the manufacturer of the cigarettes. The statute may affect commerce to some degree, but the impact of the NPM statute is probably no greater than Virginia's excise stamp law; which requires all cigarettes sold in Virginia to bear the Virginia

excise tax stamp and payment of the related tax on each pack. *See* Va. Code Ann. §§ 58.1-1000 *et seq*. That statute is designed to collect a tax for each sale of a certain product sold in the Commonwealth. So too is the NPM statute designed to collect from Star Scientific an escrow payment for each sale of their product in the Commonwealth.

Regardless of whether the NPM statute affects interstate commerce to a greater or lesser extent than other state regulation, the burden is not excessive in light of the benefit to the citizens of the Commonwealth. Section 3.1-336.2 promotes the health and welfare of the citizens of the Commonwealth by placing the economic burden of cigarette smoking on the tobacco manufacturers and their customers. Absent the NPM statute, it is possible that the future costs of treating tobacco related disease will be borne by the taxpayers of the Commonwealth. Therefore, the benefit of the NPM statute far outweighs any effect on interstate commerce. For those reasons, defendant's motion to dismiss count V of the First Amended Complaint, pursuant to Rule 12(b)(6), is GRANTED.

d. Count VI - Taking without Just Compensation.

Count VI of the First Amended Complaint alleges that the NPM statute constitutes a taking without just compensation. This count, by Star Scientific's own admission in their response to defendant Earley's motion to dismiss, fails to state a claim and therefore will not be discussed. Defendant's motion to dismiss count VI of the First Amended Complaint, pursuant to Rule 12(b)(6) is GRANTED.

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VI.

For the reasons discussed *supra*, defendant's motion to dismiss counts I and II is GRANTED pursuant to Fed. R. Civ. P. 12(b)(1), and GRANTED as to counts III through VI, pursuant to Fed R. Civ. P. 12(b)(6). Star Scientific's First Amended Complaint is DISMISSED.

An appropriate Order shall issue.

s/ James R. Spencer
UNITED STATES DISTRICT JUDGE

MAR 26 2001
DATE

Appendix B

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
RICHMOND DIVISION

Civil Action Number 3:00CV835

STAR SCIENTIFIC, INC.

Plaintiff.

v.

MARK EARLEY, in his official capacity as the Attorney General of the Commonwealth of Virginia

Defendant.

FINAL ORDER

THIS MATTER comes before the Court on defendant Earley's motion to dismiss the First Amended Complaint. For the reasons stated in the accompanying memorandum opinion, the motion to dismiss is GRANTED.

Let the Clerk send a copy of this Order, to all parties of record.

It is SO ORDERED.

s/ James R. Spencer
UNITED STATES DISTRICT JUDGE

MAR 26 2001
DATE

APPENDIX C — ORDER OF THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT DENYING PETITION FOR REHEARING AND REHEARING EN BANC FILED FEBRUARY 19, 2002

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

FILED
February 19, 2002

No. 01-1502
CA-00-835-3

STAR SCIENTIFIC, INCORPORATED,
a Delaware corporation,

Plaintiff - Appellant

v.

RANDOLPH A. BEALES, in his official capacity
as Attorney General,

Defendant - Appellee

DKT LIBERTY PROJECT; ALABAMA; ALASKA; ARIZONA; ARKANSAS; CALIFORNIA; CONNECTICUT; DELAWARE; THE DISTRICT OF COLUMBIA; GEORGIA; HAWAII; IDAHO; ILLINOIS; INDIANA; IOWA; KANSAS; KENTUCKY; LOUISIANA; MAINE; MARYLAND; MASSACHUSETTS; MICHIGAN; MINNESOTA; MISSOURI; MONTANA; NEBRASKA; NEVADA; NEW HAMPSHIRE; NEW JERSEY;

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NEW MEXICO; NEW YORK; NORTH CAROLINA; NORTH DAKOTA; NORTHERN MARIANA ISLANDS; OHIO; OKLAHOMA; OREGON; PENNSYLVANIA; PUERTO RICO; SOUTH CAROLINA; SOUTH DAKOTA; TENNESSEE; UTAH; VERMONT; WASHINGTON; WEST VIRGINIA; WISCONSIN; WYOMING; AMERICAN LEGACY FOUNDATION; AMERICAN CANCER SOCIETY; AMERICAN HEART ASSOCIATION; AMERICAN LUNG ASSOCIATION; NATIONAL CENTER FOR TOBACCO-FREE KIDS,

Amici Curiae

On Petition for Rehearing and Rehearing En Banc

The appellant's petition for rehearing and rehearing en banc was submitted to this Court. As no member of this Court or the panel requested a poll on the petition for rehearing en banc, and

As the panel considered the petition for rehearing and is of the opinion that it should be denied. Judge Widener did not participate in any decision made in this case.

IT IS ORDERED that the petition for rehearing and rehearing en banc is denied.

For the Court,

/s/ Patricia S. Connor
CLERK

APPENDIX D — RELEVANT CONSTITUTIONAL AND STATUTORY PROVISIONS

U.S. Const. Amend. XIV, § 1

> ". . . nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws."

U.S. Const., Art. I, § 8, cl. 3.

> "The Congress shall have Power . . . To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes;"

U.S. Const., Art. I, § 10, cl. 3.

> "No State shall, without the Consent of Congress, . . . enter into any Agreement or Compact with another State, or with a foreign Power. . . ."

Appendix D

VIRGINIA ACTS OF ASSEMBLY — 1999 SESSION

CHAPTER 754

An Act to amend the Code of Virginia by adding in Chapter 18 of Title 3.1 an article numbered 5, consisting of sections numbered 3.1-336.1 and 3.1-336.2, relating to participation in the Master Settlement Agreement between tobacco product manufacturers and the Commonwealth; escrow of funds by nonparticipating tobacco product manufacturers; civil penalties.

[H 2608]

Approved March 28, 1999

Whereas, cigarette smoking presents serious public health concerns to the Commonwealth and to the citizens of the Commonwealth. The Surgeon General has determined that smoking causes lung cancer, heart disease and other serious diseases, and that there are hundreds of thousands of tobacco-related deaths in the United States each year. These diseases most often do not appear until many years after the person in question begins smoking; and

Whereas, cigarette smoking also presents serious financial concerns for the Commonwealth. Under certain health-care programs, the Commonwealth may have a legal obligation to provide medical assistance to eligible persons for health conditions associated with cigarette smoking, and those persons may have a legal entitlement to receive such medical assistance; and

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Whereas, under these programs, the Commonwealth pays millions of dollars each year to provide medical assistance for these persons for health conditions associated with cigarette smoking; and

Whereas, it is the policy of the Commonwealth that financial burdens imposed on the Commonwealth by cigarette smoking be borne by tobacco product manufacturers rather than by the Commonwealth to the extent that such manufacturers either determine to enter into a settlement with the State or be found culpable by the courts; and

Whereas, on November 23, 1998, leading United States tobacco product manufacturers entered into a settlement agreement, entitled the "Master Settlement Agreement," with the Commonwealth. The Master Settlement Agreement obligates these manufacturers, in return for a release of past, present and certain future claims against them as described therein, to pay substantial sums to the Commonwealth (tied in part to their volume of sales); to fund a national foundation devoted to the interests of public health; and to make substantial changes in their advertising and marketing practices and corporate culture, with the intention of reducing underage smoking; and

Whereas, it would be contrary to the policy of the Commonwealth if tobacco product manufacturers who determine not to enter into such a settlement could use a resulting cost advantage to derive large, short-term profits in the years before liability may arise without ensuring that the Commonwealth will have an eventual source of recovery from them if they are proven to have acted culpably. It is

thus in the interest of the Commonwealth to require that such manufacturers establish a reserve fund to guarantee a source of compensation and to prevent such manufacturers from deriving large, short-term profits and then becoming judgment-proof before liability may arise; now, therefore,

Be it enacted by the General Assembly of Virginia:

1. That the Code of Virginia is amended by adding in Chapter 18 of Title 3.1 an article numbered 5, consisting of sections numbered 3.1-336.1 and 3.1-336.2, as follows:

Virginia Code Annotated § 3.1-336.1. Definitions. — As used in this article:

"Adjusted for inflation" means increased in accordance with the formula for inflation adjustment set forth in Exhibit C to the Master Settlement Agreement.

"Affiliate" means a person who directly or indirectly owns or controls, is owned or controlled by, or is under common ownership or control with, another person. Solely for purposes of this definition, the terms "owns," "is owned," and "ownership" mean ownership of an equity interest, or the equivalent thereof, of ten percent or more, and the term "person" means an individual, partnership, committee, association, corporation or any other organization or group of persons.

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"Allocable share" means Allocable Share as that term is defined in the Master Settlement Agreement.

"Cigarette" means any product that contains nicotine, is intended to be burned or heated under ordinary conditions of use, and consists of or contains (i) any roll of tobacco wrapped in paper or in any substance not containing tobacco; (ii) tobacco, in any form, that is functional in the product, which, because of its appearance, the type of tobacco used in the filler, or its packaging and labeling, is likely to be offered to, or purchased by, consumers as a cigarette; or (iii) any roll of tobacco wrapped in any substance containing tobacco which, because of its appearance, the type of tobacco used in the filler, or its packaging and labeling, is likely to be offered to, or purchased by, consumers as a cigarette described in clause (i) of this definition. The term "cigarette" includes "roll-your-own" tobacco, which means any tobacco which, because of its appearance, type, packaging, or labeling is suitable for use and likely to be offered to, or purchased by, consumers as tobacco for making cigarettes. For purposes of this definition of "cigarette," 0.09 ounces of "roll-your-own" tobacco shall constitute one individual "cigarette."

"Master Settlement Agreement" means the settlement agreement and related documents entered into on November 23, 1998, by the

Commonwealth and leading United States tobacco product manufacturers.

"Qualified-escrow fund" means an escrow arrangement with a federally or state-chartered financial institution having no affiliation with any tobacco product manufacturer and having assets of at least $1 billion where such arrangement requires that such financial institution hold the escrowed funds' principal for the benefit of releasing parties and prohibits the tobacco product manufacturer placing the funds into escrow from using, accessing or directing the use of the funds principal except as consistent with subsection B of § 3.1-336.2.

"Released claims" means Released Claims as that term is defined in the Master Settlement Agreement.

"Releasing parties" means Releasing Parties as that term is defined in the Master Settlement Agreement.

"Tobacco product manufacturer" means an entity that after the date of enactment of this act directly (and not exclusively through any affiliate):

1. Manufactures cigarettes anywhere that such manufacturer intends to be sold in the United States, including cigarettes intended to be sold in the United States through an importer (except where such

importer is an original participating manufacturer (as that term is defined in the Master Settlement Agreement) that will be responsible for the payments under the Master Settlement Agreement with respect to such cigarettes as a result of the provisions of subsections II (mm) of the Master Settlement Agreement and that pays the taxes specified in subsection II (z) of the Master Settlement Agreement, and provided that the manufacturer of such cigarettes does not market or advertise such cigarettes in the United States);

2. Is the first purchaser anywhere for resale in the United States of cigarettes manufactured anywhere that the manufacturer does not intend to be sold in the United States; or

3. Becomes a successor of an entity described in subdivision 1 or 2 of this definition.

The term "Tobacco Product Manufacturer" shall not include an affiliate of a tobacco product manufacturer unless such affiliate itself falls within any of subdivisions 1, 2, and 3 of this definition.

"*Units sold*" means the number of individual cigarettes sold in the Commonwealth by the applicable tobacco product manufacturer, whether

directly or through a distributor, retailer or similar intermediary or intermediaries, during the year in question, as measured by excise taxes collected by the Commonwealth on packs (or "roll-your-own" tobacco containers) bearing the excise tax stamp of the Commonwealth. (1999, cc. 714, 754.)

Virginia Code Annotated § 3.1-336.2. Requirements on tobacco product manufacturers; escrow of funds; civil penalties for violations. — A. Any tobacco product manufacturer selling cigarettes to consumers within the Commonwealth, whether directly or through a distributor, retailer or similar intermediary or intermediaries, after July 1, 1999, shall do one of the following:

1. Become a participating manufacturer (as that term is defined in section II (jj) of the Master Settlement Agreement) and generally perform its financial obligations under the Master Settlement Agreement; or

2. Place into a qualified escrow fund by April 15 of the year following the year in question the following amounts (as such amounts are adjusted for inflation):

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Year	Amount per unit sold in such year (except for 1999, the amount per unit sold after July 1, 1999)
1999	$.0094241
2000	$.0104712
each of 2001 and 2002	$.0136125
each of 2003 through 2006	$.0167539
each of 2007 and each year thereafter	$.0188482

B. A tobacco product manufacturer that places funds into escrow pursuant to subdivision A 2 shall receive the interest or other appreciation on such funds as earned. Such funds themselves shall be released from escrow only under the following circumstances:

1. To pay a judgment or settlement on any released claim brought against such tobacco product manufacturer by the Commonwealth or any releasing party located or residing in the Commonwealth. Funds shall be released from escrow under this subdivision (i) in the order in which they were placed into escrow and (ii) only to the extent and at the time necessary to make payments required under such judgment or settlement;

2. To the extent that a tobacco product manufacturer establishes that the amount it was required to place into escrow in a particular year was greater than the Commonwealth's allocable share of the total payments that such manufacturer would have been required to make in that year under

the Master Settlement Agreement (as determined pursuant to section IX(1) (2) of the Master Settlement Agreement, and before any of the adjustments or offsets described in section IX(i) (3) of that Agreement other than the Inflation Adjustment) had it been a participating manufacturer, the excess shall be released from escrow and revert back to such tobacco product manufacturer; or

3. To the extent not released from escrow under subdivisions 1 or 2, funds shall be released from escrow and revert back to such tobacco product manufacturer twenty-five years after the date on which they were placed into escrow.

C. Each tobacco product manufacturer that elects to place funds into escrow pursuant to subdivision A 2 shall annually certify to the Attorney General that it is in compliance with that subdivision. The Attorney General may bring a civil action on behalf of the Commonwealth against any tobacco product manufacturer that fails to place into escrow the funds required under this section. Any tobacco product manufacturer that fails in any year to place into escrow the funds required under this section shall:

1. Be required within fifteen days to place such funds into escrow as shall bring it into compliance with this section. The court, upon a finding of a violation of this subsection, may impose a civil penalty, to be paid to the general fund of the Commonwealth, in an amount not to exceed five

percent of the amount improperly withheld from escrow per day of the violation and in a total amount not to exceed 100 percent of the original amount improperly withheld from escrow;

2. In the case of a knowing violation, be required within fifteen days to place such funds into escrow as shall bring it into compliance with this section. The court, upon a finding of a knowing violation of this subsection, may impose a civil penalty, to be paid to the general fund of the Commonwealth, in an amount not to exceed fifteen percent of the amount improperly withheld from escrow per day of the violation and in a total amount not to exceed 300 percent of the original amount improperly withheld from escrow; and

3. In the case of a second knowing violation, be prohibited from selling cigarettes to consumers within the Commonwealth (whether directly or through a distributor, retailer or similar intermediary) for a period not to exceed two years.

Each failure to make an annual deposit required under this section shall constitute a separate violation. (1999, cc. 714, 754.)

APPENDIX E — EXCERPTS FROM THE MASTER SETTLEMENT AGREEMENT

MASTER SETTLEMENT AGREEMENT

This Master Settlement Agreement is made by the undersigned Settling State officials (on behalf of their respective Settling States) and the undersigned Participating Manufacturers to settle and resolve with finality all Released Claims against the Participating Manufacturers and related entities as set forth herein. This Agreement constitutes the documentation effecting this settlement with respect to each Settling State, and is intended to and shall be binding upon each Settling State and each Participating Manufacturer in accordance with the terms hereof.

I. RECITALS

WHEREAS, more than 40 States have commenced litigation asserting various claims for monetary, equitable and injunctive relief against certain tobacco product manufacturers and others as defendants, and the States that have not filed suit can potentially assert similar claims;

WHEREAS, the Settling States that have commenced litigation have sought to obtain equitable relief and damages under state laws, including consumer protection and/or antitrust laws, in order to further the Settling States' policies regarding public health, including policies adopted to achieve a significant reduction in smoking by Youth;

WHEREAS, defendants have denied each and every one of the Settling States' allegations of unlawful conduct or wrongdoing and have asserted a number of defenses to the Settling States' claims, which defenses have been contested by the Settling States;

WHEREAS, the Settling States and the Participating Manufacturers are committed to reducing underage tobacco use by discouraging such use and by preventing Youth access to Tobacco Products;

WHEREAS, the Participating Manufacturers recognize the concern of the tobacco grower community that it may be adversely affected by the potential reduction in tobacco consumption resulting from this settlement, reaffirm their commitment to work cooperatively to address concerns about the potential adverse economic impact on such community, and will, within 30 days after the MSA Execution Date, meet with the political leadership of States with grower communities to address these economic concerns;

WHEREAS, the undersigned Settling State officials believe that entry into this Agreement and uniform consent decrees with the tobacco industry is necessary in order to further the Settling States' policies designed to reduce Youth smoking, to promote the public health and to secure monetary payments to the Settling States; and

WHEREAS, the Settling States and the Participating Manufacturers wish to avoid the further expense, delay, inconvenience, burden and uncertainty of continued litigation (including appeals from any verdicts), and, therefore, have agreed to settle their respective lawsuits and potential claims pursuant to terms which will achieve for the Settling States and their citizens significant funding for the advancement of public health, the implementation of important tobacco-related public health measures, including the enforcement of the mandates and restrictions related to such measures,

as well as funding for a national Foundation dedicated to significantly reducing the use of Tobacco Products by Youth;

NOW, THEREFORE, BE IT KNOWN THAT, in consideration of the implementation of tobacco-related health measures and the payments to be made by the Participating Manufacturers, the release and discharge of all claims by the Settling States, and such other consideration as described herein, the sufficiency of which is hereby acknowledged, the Settling States and the Participating Manufacturers, acting by and through their authorized agents, memorialize and agree as follows:

II. DEFINITIONS

(a) "Account" has the meaning given in the Escrow Agreement.

(b) "Adult" means any person or persons who are not Underage.

(c) "Adult-Only Facility" means a facility or restricted area (whether open-air or enclosed) where the operator ensures or has a reasonable basis to believe (such as by checking identification as required under state law, or by checking the identification of any person appearing to be under the age of 27) that no Underage person is present. A facility or restricted area need not be permanently restricted to Adults in order to constitute an Adult-Only Facility, provided that the operator ensures or has a reasonable basis to believe that no Underage person is present during the event or time period in question.

(d) "Affiliate" means a person who directly or indirectly owns or controls, is owned or controlled by, or is under common ownership or control with, another person. Solely for purposes of this definition, the terms "owns," "is owned" and "ownership" mean ownership of an equity interest, or the equivalent thereof, of 10 percent or more, and the term "person" means an individual, partnership, committee, association, corporation or any other organization or group of persons.

(e) "Agreement" means this Master Settlement Agreement, together with the exhibits hereto, as it may be amended pursuant to subsection XVIII(j).

(f) "Allocable Share" means the percentage set forth for the State in question as listed in Exhibit A hereto, without regard to any subsequent alteration or modification of such State's percentage share agreed to by or among any States; or, solely for the purpose of calculating payments under subsection IX(c)(2) (and corresponding payments under subsection IX(i)), the percentage disclosed for the State in question pursuant to subsection IX(c)(2)(A) prior to June 30, 1999, without regard to any subsequent alteration or modification of such State's percentage share agreed to by or among any States.

(g) "Allocated Payment" means a particular Settling State's Allocable Share of the sum of all of the payments to be made by the Original Participating Manufacturers in the year in question pursuant to subsections IX(c)(1) and IX(c)(2), as such payments have been adjusted, reduced and allocated pursuant to clause "First" through the first sentence of clause "Fifth" of subsection IX(j), but before application

of the other offsets and adjustments described in clauses "Sixth" through "Thirteenth" of subsection IX(j).

(h) "Bankruptcy" means, with respect to any entity, the commencement of a case or other proceeding (whether voluntary or involuntary) seeking any of (1) liquidation, reorganization, rehabilitation, receivership, conservatorship, or other relief with respect to such entity or its debts under any bankruptcy, insolvency or similar law now or hereafter in effect; (2) the appointment of a trustee, receiver, liquidator, custodian or similar official of such entity or any substantial part of its business or property; (3) the consent of such entity to any of the relief described in (1) above or to the appointment of any official described in (2) above in any such case or other proceeding involuntarily commenced against such entity; or (4) the entry of an order for relief as to such entity under the federal bankruptcy laws as now or hereafter in effect. Provided, however, that an involuntary case or proceeding otherwise within the foregoing definition shall not be a "Bankruptcy" if it is or was dismissed within 60 days of its commencement.

(i) "Brand Name" means a brand name (alone or in conjunction with any other word), trademark, logo, symbol, motto, selling message, recognizable pattern of colors, or any other indicia of product identification identical or similar to, or identifiable with, those used for any domestic brand of Tobacco Products. Provided, however, that the term "Brand Name" shall not include the corporate name of any Tobacco Product Manufacturer that does not after the MSA Execution Date sell a brand of Tobacco Products in the States that includes such corporate name.

(j) "Brand Name Sponsorship" means an athletic, musical, artistic, or other social or cultural event as to which payment is made (or other consideration is provided) in exchange for use of a Brand Name or Names (1) as part of the name of the event or (2) to identify, advertise, or promote such event or an entrant, participant or team in such event in any other way. Sponsorship of a single national or multi-state series or tour (for example, NASCAR (including any number of NASCAR races)), or of one or more events within a single national or multi-state series or tour, or of an entrant, participant, or team taking part in events sanctioned by a single approving organization (e.g., NASCAR or CART), constitutes one Brand Name Sponsorship. Sponsorship of an entrant, participant, or team by a Participating Manufacturer using a Brand Name or Names in an event that is part of a series or tour that is sponsored by such Participating Manufacturer or that is part of a series or tour in which any one or more events are sponsored by such Participating Manufacturer does not constitute a separate Brand Name Sponsorship. Sponsorship of an entrant, participant, or team by a Participating Manufacturer using a Brand Name or Names in any event (or series of events) not sponsored by such Participating Manufacturer constitutes a Brand Name Sponsorship. The term "Brand Name Sponsorship" shall not include an event in an Adult-Only Facility.

(k) "Business Day" means a day which is not a Saturday or Sunday or legal holiday on which banks are authorized or required to close in New York, New York.

(l) "Cartoon" means any drawing or other depiction of an object, person, animal, creature or any similar caricature that satisfies any of the following criteria:

(1) the use of comically exaggerated features;

(2) the attribution of human characteristics to animals, plants or other objects, or the similar use of anthropomorphic technique; or

(3) the attribution of unnatural or extrahuman abilities, such as imperviousness to pain or injury, X-ray vision, tunneling at very high speeds or transformation.

The term "Cartoon" includes "Joe Camel," but does not include any drawing or other depiction that on July 1, 1998, was in use in any State in any Participating Manufacturer's corporate logo or in any Participating Manufacturer's Tobacco Product packaging.

(m) "Cigarette" means any product that contains nicotine, is intended to be burned or heated under ordinary conditions of use, and consists of or contains (1) any roll of tobacco wrapped in paper or in any substance not containing tobacco; or (2) tobacco, in any form, that is functional in the product, which, because of its appearance, the type of tobacco used in the filler, or its packaging and labeling, is likely to be offered to, or purchased by, consumers as a cigarette; or (3) any roll of tobacco wrapped in any substance containing tobacco which, because of its appearance, the type of tobacco used in the filler, or its packaging and labeling, is likely to be offered to, or purchased by, consumers as a cigarette described in clause (1) of this definition. The term "Cigarette" includes "roll-your-own" (i.e., any tobacco which, because of its appearance, type, packaging, or labeling is suitable for

use and likely to be offered to, or purchased by, consumers as tobacco for making cigarettes). Except as provided in subsections II(z) and II(mm), 0.0325 ounces of "roll-your-own" tobacco shall constitute one individual "Cigarette."

(n) "Claims" means any and all manner of civil (i.e., non-criminal): claims, demands, actions, suits, causes of action, damages (whenever incurred), liabilities of any nature including civil penalties and punitive damages, as well as costs, expenses and attorneys' fees (except as to the Original Participating Manufacturers' obligations under section XVII), known or unknown, suspected or unsuspected, accrued or unaccrued, whether legal, equitable, or statutory.

(o) "Consent Decree" means a state-specific consent decree as described in subsection XIII(b)(1)(B) of this Agreement.

(p) "Court" means the respective court in each Settling State to which this Agreement and the Consent Decree are presented for approval and/or entry as to that Settling State.

(q) "Escrow" has the meaning given in the Escrow Agreement.

(r) "Escrow Agent" means the escrow agent under the Escrow Agreement.

(s) "Escrow Agreement" means an escrow agreement substantially in the form of Exhibit B.

(t) "Federal Tobacco Legislation Offset" means the offset described in section X.

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(u) "Final Approval" means the earlier of:

(1) the date by which State-Specific Finality in a sufficient number of Settling States has occurred; or

(2) June 30, 2000.

For the purposes of this subsection (u), "State-Specific Finality in a sufficient number of Settling States" means that State-Specific Finality has occurred in both:

(A) a number of Settling States equal to at least 80% of the total number of Settling States; and

(B) Settling States having aggregate Allocable Shares equal to at least 80% of the total aggregate Allocable Shares assigned to all Settling States.

Notwithstanding the foregoing, the Original Participating Manufacturers may, by unanimous written agreement, waive any requirement for Final Approval set forth in subsections (A) or (B) hereof.

(v) "Foundation" means the foundation described in section VI.

(w) "Independent Auditor" means the firm described in subsection XI(b).

(x) "Inflation Adjustment" means an adjustment in accordance with the formulas for inflation adjustments set forth in Exhibit C.

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(y) "Litigating Releasing Parties Offset" means the offset described in subsection XII(b).

(z) "Market Share" means a Tobacco Product Manufacturer's respective share (expressed as a percentage) of the total number of individual Cigarettes sold in the fifty United States, the District of Columbia and Puerto Rico during the applicable calendar year, as measured by excise taxes collected by the federal government and, in the case of sales in Puerto Rico, arbitrios de cigarillos collected by the Puerto Rico taxing authority. For purposes of the definition and determination of "Market Share" with respect to calculations under subsection IX(i), 0.09 ounces of "roll your own" tobacco shall constitute one individual Cigarette; for purposes of the definition and determination of "Market Share" with respect to all other calculations, 0.0325 ounces of "roll your own" tobacco shall constitute one individual Cigarette.

(aa) "MSA Execution Date" means November 23, 1998.

(bb) "NAAG" means the National Association of Attorneys General, or its successor organization that is directed by the Attorneys General to perform certain functions under this Agreement.

(cc) "Non-Participating Manufacturer" means any Tobacco Product Manufacturer that is not a Participating Manufacturer.

(dd) "Non-Settling States Reduction" means a reduction determined by multiplying the amount to which such reduction applies by the aggregate Allocable Shares of those

States that are not Settling States on the date 15 days before such payment is due.

(ee) "Notice Parties" means each Participating Manufacturer, each Settling State, the Escrow Agent, the Independent Auditor and NAAG.

(ff) "NPM Adjustment" means the adjustment specified in subsection IX(d).

(gg) "NPM Adjustment Percentage" means the percentage determined pursuant to subsection IX(d).

(hh) "Original Participating Manufacturers" means the following: Brown & Williamson Tobacco Corporation, Lorillard Tobacco Company, Philip Morris Incorporated and R.J. Reynolds Tobacco Company, and the respective successors of each of the foregoing. Except as expressly provided in this Agreement, once an entity becomes an Original Participating Manufacturer, such entity shall permanently retain the status of Original Participating Manufacturer.

(ii) "Outdoor Advertising" means (1) billboards, (2) signs and placards in arenas, stadiums, shopping malls and Video Game Arcades (whether any of the foregoing are open air or enclosed) (but not including any such sign or placard located in an Adult-Only Facility), and (3) any other advertisements placed (A) outdoors, or (B) on the inside surface of a window facing outward. Provided, however, that the term "Outdoor Advertising" does not mean (1) an advertisement on the outside of a Tobacco Product manufacturing facility; (2) an individual advertisement that does not occupy an area larger

than 14 square feet (and that neither is placed in such proximity to any other such advertisement so as to create a single "mosaic"-type advertisement larger than 14 square feet, nor functions solely as a segment of a larger advertising unit or series), and that is placed (A) on the outside of any retail establishment that sells Tobacco Products (other than solely through a vending machine), (B) outside (but on the property of) any such establishment, or (C) on the inside surface of a window facing outward in any such establishment; (3) an advertisement inside a retail establishment that sells Tobacco Products (other than solely through a vending machine) that is not placed on the inside surface of a window facing outward; or (4) an outdoor advertisement at the site of an event to be held at an Adult-Only Facility that is placed at such site during the period the facility or enclosed area constitutes an Adult-Only Facility, but in no event more than 14 days before the event, and that does not advertise any Tobacco Product (other than by using a Brand Name to identify the event).

(jj) "Participating Manufacturer" means a Tobacco Product Manufacturer that is or becomes a signatory to this Agreement, provided that (1) in the case of a Tobacco Product Manufacturer that is not an Original Participating Manufacturer, such Tobacco Product Manufacturer is bound by this Agreement and the Consent Decree (or, in any Settling State that does not permit amendment of the Consent Decree, a consent decree containing terms identical to those set forth in the Consent Decree) in all Settling States in which this Agreement and the Consent Decree binds Original Participating Manufacturers (provided, however, that such Tobacco Product Manufacturer need only become bound by the Consent Decree in those Settling States in which the Settling State has filed a Released Claim against it), and (2) in the

case of a Tobacco Product Manufacturer that signs this Agreement after the MSA Execution Date, such Tobacco Product Manufacturer, within a reasonable period of time after signing this Agreement, makes any payments (including interest thereon at the Prime Rate) that it would have been obligated to make in the intervening period had it been a signatory as of the MSA Execution Date. "Participating Manufacturer" shall also include the successor of a Participating Manufacturer. Except as expressly provided in this Agreement, once an entity becomes a Participating Manufacturer such entity shall permanently retain the status of Participating Manufacturer. Each Participating Manufacturer shall regularly report its shipments of Cigarettes in or to the fifty United States, the District of Columbia and Puerto Rico to Management Science Associates, Inc. (or a successor entity as set forth in subsection (mm)). Solely for purposes of calculations pursuant to subsection IX(d), a Tobacco Product Manufacturer that is not a signatory to this Agreement shall be deemed to be a "Participating Manufacturer" if the Original Participating Manufacturers unanimously consent in writing.

(kk) "Previously Settled States Reduction" means a reduction determined by multiplying the amount to which such reduction applies by 12.4500000%, in the case of payments due in or prior to 2007; 12.2373756%, in the case of payments due after 2007 but before 2018; and 11.0666667%, in the case of payments due in or after 2018.

(ll) "Prime Rate" shall mean the prime rate as published from time to time by the Wall Street Journal or, in the event the Wall Street Journal is no longer published or no longer publishes such rate, an equivalent successor reference rate determined by the Independent Auditor.

(mm) "Relative Market Share" means an Original Participating Manufacturer's respective share (expressed as a percentage) of the total number of individual Cigarettes shipped in or to the fifty United States, the District of Columbia and Puerto Rico by all the Original Participating Manufacturers during the calendar year immediately preceding the year in which the payment at issue is due (regardless of when such payment is made), as measured by the Original Participating Manufacturers' reports of shipments of Cigarettes to Management Science Associates, Inc. (or a successor entity acceptable to both the Original Participating Manufacturers and a majority of those Attorneys General who are both the Attorney General of a Settling State and a member of the NAAG executive committee at the time in question). A Cigarette shipped by more than one Participating Manufacturer shall be deemed to have been shipped solely by the first Participating Manufacturer to do so. For purposes of the definition and determination of "Relative Market Share," 0.09 ounces of "roll your own" tobacco shall constitute one individual Cigarette.

(nn) "Released Claims" means:

(1) for past conduct, acts or omissions (including any damages incurred in the future arising from such past conduct, acts or omissions), those Claims directly or indirectly based on, arising out of or in any way related, in whole or in part, to (A) the use, sale, distribution, manufacture, development, advertising, marketing or health effects of, (B) the exposure to, or (C) research, statements, or warnings regarding, Tobacco Products (including,

but not limited to, the Claims asserted in the actions identified in Exhibit D, or any comparable Claims that were, could be or could have been asserted now or in the future in those actions or in any comparable action in federal, state or local court brought by a Settling State or a Releasing Party (whether or not such Settling State or Releasing Party has brought such action)), except for claims not asserted in the actions identified in Exhibit D for outstanding liability under existing licensing (or similar) fee laws or existing tax laws (but not excepting claims for any tax liability of the Tobacco-Related Organizations or of any Released Party with respect to such Tobacco-Related Organizations, which claims are covered by the release and covenants set forth in this Agreement);

(2) for future conduct, acts or omissions, only those monetary Claims directly or indirectly based on, arising out of or in any way related to, in whole or in part, the use of or exposure to Tobacco Products manufactured in the ordinary course of business, including without limitation any future Claims for reimbursement of health care costs allegedly associated with the use of or exposure to Tobacco Products.

(oo) "Released Parties" means all Participating Manufacturers, their past, present and future Affiliates, and the respective divisions, officers, directors, employees, representatives, insurers, lenders, underwriters, Tobacco-Related Organizations, trade associations, suppliers, agents,

auditors, advertising agencies, public relations entities, attorneys, retailers and distributors of any Participating Manufacturer or of any such Affiliate (and the predecessors, heirs, executors, administrators, successors and assigns of each of the foregoing). Provided, however, that "Released Parties" does not include any person or entity (including, but not limited to, an Affiliate) that is itself a Non-Participating Manufacturer at any time after the MSA Execution Date, unless such person or entity becomes a Participating Manufacturer.

(pp) "Releasing Parties" means each Settling State and any of its past, present and future agents, officials acting in their official capacities, legal representatives, agencies, departments, commissions and divisions; and also means, to the full extent of the power of the signatories hereto to release past, present and future claims, the following: (1) any Settling State's subdivisions (political or otherwise, including, but not limited to, municipalities, counties, parishes, villages, unincorporated districts and hospital districts), public entities, public instrumentalities and public educational institutions; and (2) persons or entities acting in a parens patriae, sovereign, quasi-sovereign, private attorney general, qui tam, taxpayer, or any other capacity, whether or not any of them participate in this settlement, (A) to the extent that any such person or entity is seeking relief on behalf of or generally applicable to the general public in such Settling State or the people of the State, as opposed solely to private or individual relief for separate and distinct injuries, or (B) to the extent that any such entity (as opposed to an individual) is seeking recovery of health-care expenses (other than premium or capitation payments for the benefit of present or retired state employees) paid or reimbursed, directly or indirectly, by a Settling State.

(qq) "Settling State" means any State that signs this Agreement on or before the MSA Execution Date. Provided, however, that the term "Settling State" shall not include (1) the States of Mississippi, Florida, Texas and Minnesota; and (2) any State as to which this Agreement has been terminated.

(rr) "State" means any state of the United States, the District of Columbia, the Commonwealth of Puerto Rico, Guam, the Virgin Islands, American Samoa, and the Northern Marianas.

(ss) "State-Specific Finality" means, with respect to the Settling State in question:

(1) this Agreement and the Consent Decree have been approved and entered by the Court as to all Original Participating Manufacturers, or, in the event of an appeal from or review of a decision of the Court to withhold its approval and entry of this Agreement and the Consent Decree, by the court hearing such appeal or conducting such review;

(2) entry by the Court has been made of an order dismissing with prejudice all claims against Released Parties in the action as provided herein; and

(3) the time for appeal or to seek review of or permission to appeal ("Appeal") from the approval and entry as described in subsection (1) hereof and entry of such order described in subsection (2) hereof has expired; or, in the event of an Appeal from such approval and entry, the Appeal has been dismissed, or the approval and entry described in

(1) hereof and the order described in subsection (2) hereof have been affirmed in all material respects by the court of last resort to which such Appeal has been taken and such dismissal or affirmance has become no longer subject to further Appeal (including, without limitation, review by the United States Supreme Court).

(tt) "Subsequent Participating Manufacturer" means a Tobacco Product Manufacturer (other than an Original Participating Manufacturer) that: (1) is a Participating Manufacturer, and (2) is a signatory to this Agreement, regardless of when such Tobacco Product Manufacturer became a signatory to this Agreement. "Subsequent Participating Manufacturer" shall also include the successors of a Subsequent Participating Manufacturer. Except as expressly provided in this Agreement, once an entity becomes a Subsequent Participating Manufacturer such entity shall permanently retain the status of Subsequent Participating Manufacturer, unless it agrees to assume the obligations of an Original Participating Manufacturer as provided in subsection XVIII(c).

(uu) "Tobacco Product Manufacturer" means an entity that after the MSA Execution Date directly (and not exclusively through any Affiliate):

(1) manufactures Cigarettes anywhere that such manufacturer intends to be sold in the States, including Cigarettes intended to be sold in the States through an importer (except where such importer is an Original Participating Manufacturer

that will be responsible for the payments under this Agreement with respect to such Cigarettes as a result of the provisions of subsections II(mm) and that pays the taxes specified in subsection II(z) on such Cigarettes, and provided that the manufacturer of such Cigarettes does not market or advertise such Cigarettes in the States);

(2) is the first purchaser anywhere for resale in the States of Cigarettes manufactured anywhere that the manufacturer does not intend to be sold in the States; or

(3) becomes a successor of an entity described in subsection (1) or (2) above.

The term "Tobacco Product Manufacturer" shall not include an Affiliate of a Tobacco Product Manufacturer unless such Affiliate itself falls within any of subsections (1) — (3) above.

(vv) "Tobacco Products" means Cigarettes and smokeless tobacco products.

(ww) "Tobacco-Related Organizations" means the Council for Tobacco Research-U.S.A., Inc., The Tobacco Institute, Inc. ("TI"), and the Center for Indoor Air Research, Inc. ("CIAR") and the successors, if any, of TI or CIAR.

(xx) "Transit Advertisements" means advertising on or within private or public vehicles and all advertisements placed at, on or within any bus stop, taxi stand, transportation waiting area, train station, airport or any similar location.

Notwithstanding the foregoing, the term "Transit Advertisements" does not include (1) any advertisement placed in, on or outside the premises of any retail establishment that sells Tobacco Products (other than solely through a vending machine) (except if such individual advertisement (A) occupies an area larger than 14 square feet; (B) is placed in such proximity to any other such advertisement so as to create a single "mosaic"-type advertisement larger than 14 square feet; or (C) functions solely as a segment of a larger advertising unit or series); or (2) advertising at the site of an event to be held at an Adult-Only Facility that is placed at such site during the period the facility or enclosed area constitutes an Adult-Only Facility, but in no event more than 14 days before the event, and that does not advertise any Tobacco Product (other than by using a Brand Name to identify the event).

(yy) "Underage" means younger than the minimum age at which it is legal to purchase or possess (whichever minimum age is older) Cigarettes in the applicable Settling State.

(zz) "Video Game Arcade" means an entertainment establishment primarily consisting of video games (other than video games intended primarily for use by persons 18 years of age or older) and/or pinball machines.

(aaa) "Volume Adjustment" means an upward or downward adjustment in accordance with the formula for volume adjustments set forth in Exhibit E.

(bbb) "Youth" means any person or persons under 18 years of age.

Appendix E

III. PERMANENT RELIEF

(a) *Prohibition on Youth Targeting*. No Participating Manufacturer may take any action, directly or indirectly, to target Youth within any Settling State in the advertising, promotion or marketing of Tobacco Products, or take any action the primary purpose of which is to initiate, maintain or increase the incidence of Youth smoking within any Settling State.

(b) *Ban on Use of Cartoons*. Beginning 180 days after the MSA Execution Date, no Participating Manufacturer may use or cause to be used any Cartoon in the advertising, promoting, packaging or labeling of Tobacco Products.

(c) *Limitation of Tobacco Brand Name Sponsorships*.

(1) *Prohibited Sponsorships*. After the MSA Execution Date, no Participating Manufacturer may engage in any Brand Name Sponsorship in any State consisting of:

(A) concerts; or

(B) events in which the intended audience is comprised of a significant percentage of Youth; or

(C) events in which any paid participants or contestants are Youth; or

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(D) any athletic event between opposing teams in any football, basketball, baseball, soccer or hockey league.

(2) *Limited Sponsorships.*

(A) No Participating Manufacturer may engage in more than one Brand Name Sponsorship in the States in any twelve-month period (such period measured from the date of the initial sponsored event).

(B) Provided, however, that

(i) nothing contained in subsection (2)(A) above shall require a Participating Manufacturer to breach or terminate any sponsorship contract in existence as of August 1, 1998 (until the earlier of (x) the current term of any existing contract, without regard to any renewal or option that may be exercised by such Participating Manufacturer or (y) three years after the MSA Execution Date); and

(ii) notwithstanding subsection (1)(A) above, Brown & Williamson Tobacco Corporation may sponsor either the GPC country music festival

or the Kool jazz festival as its one annual Brand Name Sponsorship permitted pursuant to subsection (2)(A) as well as one Brand Name Sponsorship permitted pursuant to subsection (2)(B)(i).

(3) *Related Sponsorship Restrictions.* With respect to any Brand Name Sponsorship permitted under this subsection (c):

(A) advertising of the Brand Name Sponsorship event shall not advertise any Tobacco Product (other than by using the Brand Name to identify such Brand Name Sponsorship event);

(B) no Participating Manufacturer may refer to a Brand Name Sponsorship event or to a celebrity or other person in such an event in its advertising of a Tobacco Product;

(C) nothing contained in the provisions of subsection III(e) of this Agreement shall apply to actions taken by any Participating Manufacturer in connection with a Brand Name Sponsorship permitted pursuant to the provisions of subsections (2)(A) and (2)(B)(i); the Brand Name Sponsorship permitted by subsection (2)(B)(ii) shall be subject

to the restrictions of subsection III(e) except that such restrictions shall not prohibit use of the Brand Name to identify the Brand Name Sponsorship;

nothing contained in the provisions of subsections III(f) and III(i) shall apply to apparel or other merchandise: (i) marketed, distributed, offered, sold, or licensed at the site of a Brand Name Sponsorship permitted pursuant to subsections (2)(A) or (2)(B)(i) by the person to which the relevant Participating Manufacturer has provided payment in exchange for the use of the relevant Brand Name in the Brand Name Sponsorship or a third-party that does not receive payment from the relevant Participating Manufacturer (or any Affiliate of such Participating Manufacturer) in connection with the marketing, distribution, offer, sale or license of such apparel or other merchandise; or (ii) used at the site of a Brand Name Sponsorship permitted pursuant to subsection (2)(A) or (2)(B)(i) (during such event) that are not distributed (by sale or otherwise) to any member of the general public; and

(E) nothing contained in the provisions of subsection III(d) shall: (i) apply to the use of a Brand Name on a vehicle

used in a Brand Name Sponsorship; or (ii) apply to Outdoor Advertising advertising the Brand Name Sponsorship, to the extent that such Outdoor Advertising is placed at the site of a Brand Name Sponsorship no more than 90 days before the start of the initial sponsored event, is removed within 10 days after the end of the last sponsored event, and is not prohibited by subsection (3)(A) above.

(4) *Corporate Name Sponsorships*. Nothing in this subsection (c) shall prevent a Participating Manufacturer from sponsoring or causing to be sponsored any athletic, musical, artistic, or other social or cultural event, or any entrant, participant or team in such event (or series of events) in the name of the corporation which manufactures Tobacco Products, provided that the corporate name does not include any Brand Name of domestic Tobacco Products.

(5) *Naming Rights Prohibition*. No Participating Manufacturer may enter into any agreement for the naming rights of any stadium or arena located within a Settling State using a Brand Name, and shall not otherwise cause a stadium or arena located within a Settling State to be named with a Brand Name.

(6) *Prohibition on Sponsoring Teams and Leagues*. No Participating Manufacturer may

enter into any agreement pursuant to which payment is made (or other consideration is provided) by such Participating Manufacturer to any football, basketball, baseball, soccer or hockey league (or any team involved in any such league) in exchange for use of a Brand Name.

(d) *Elimination of Outdoor Advertising and Transit Advertisements.* Each Participating Manufacturer shall discontinue Outdoor Advertising and Transit Advertisements advertising Tobacco Products within the Settling States as set forth herein.

(1) *Removal.* Except as otherwise provided in this section, each Participating Manufacturer shall remove from within the Settling States within 150 days after the MSA Execution Date all of its (A) billboards (to the extent that such billboards constitute Outdoor Advertising) advertising Tobacco Products; (B) signs and placards (to the extent that such signs and placards constitute Outdoor Advertising) advertising Tobacco Products in arenas, stadiums, shopping malls and Video Game Arcades; and (C) Transit Advertisements advertising Tobacco Products.

(2) *Prohibition on New Outdoor Advertising and Transit Advertisements.* No Participating Manufacturer may, after the MSA Execution Date, place or cause to be placed any new Outdoor Advertising advertising Tobacco Products or new Transit Advertisements advertising Tobacco Products within any Settling State.

(3) *Alternative Advertising*. With respect to those billboards required to be removed under subsection (1) that are leased (as opposed to owned) by any Participating Manufacturer, the Participating Manufacturer will allow the Attorney General of the Settling State within which such billboards are located to substitute, at the Settling State's option, alternative advertising intended to discourage the use of Tobacco Products by Youth and their exposure to second-hand smoke for the remaining term of the applicable contract (without regard to any renewal or option term that may be exercised by such Participating Manufacturer). The Participating Manufacturer will bear the cost of the lease through the end of such remaining term. Any other costs associated with such alternative advertising will be borne by the Settling State.

(4) *Ban on Agreements Inhibiting Anti-Tobacco Advertising*. Each Participating Manufacturer agrees that it will not enter into any agreement that prohibits a third party from selling, purchasing or displaying advertising discouraging the use of Tobacco Products or exposure to second-hand smoke. In the event and to the extent that any Participating Manufacturer has entered into an agreement containing any such prohibition, such Participating Manufacturer agrees to waive such prohibition in such agreement.

(5) *Designation of Contact Person.* Each Participating Manufacturer that has Outdoor Advertising or Transit Advertisements advertising Tobacco Products within a Settling State shall, within 10 days after the MSA Execution Date, provide the Attorney General of such Settling State with the name of a contact person to whom the Settling State may direct inquiries during the time such Outdoor Advertising and Transit Advertisements are being eliminated, and from whom the Settling State may obtain periodic reports as to the progress of their elimination.

(6) *Adult-Only Facilities.* To the extent that any advertisement advertising Tobacco Products located within an Adult-Only Facility constitutes Outdoor Advertising or a Transit Advertisement, this subsection (d) shall not apply to such advertisement, provided such advertisement is not visible to persons outside such Adult-Only Facility.

(e) *Prohibition on Payments Related to Tobacco Products and Media.* No Participating Manufacturer may, beginning 30 days after the MSA Execution Date, make, or cause to be made, any payment or other consideration to any other person or entity to use, display, make reference to or use as a prop any Tobacco Product, Tobacco Product package, advertisement for a Tobacco Product, or any other item bearing a Brand Name in any motion picture, television show, theatrical production or other live performance, live or recorded performance of music, commercial film or video, or video game ("Media"); provided, however, that the

foregoing prohibition shall not apply to (1) Media where the audience or viewers are within an Adult-Only Facility (provided such Media are not visible to persons outside such Adult-Only Facility); (2) Media not intended for distribution or display to the public; or (3) instructional Media concerning non-conventional cigarettes viewed only by or provided only to smokers who are Adults.

(f) *Ban on Tobacco Brand Name Merchandise.* Beginning July 1, 1999, no Participating Manufacturer may, within any Settling State, market, distribute, offer, sell, license or cause to be marketed, distributed, offered, sold or licensed (including, without limitation, by catalogue or direct mail), any apparel or other merchandise (other than Tobacco Products, items the sole function of which is to advertise Tobacco Products, or written or electronic publications) which bears a Brand Name. Provided, however, that nothing in this subsection shall (1) require any Participating Manufacturer to breach or terminate any licensing agreement or other contract in existence as of June 20, 1997 (this exception shall not apply beyond the current term of any existing contract, without regard to any renewal or option term that may be exercised by such Participating Manufacturer); (2) prohibit the distribution to any Participating Manufacturer's employee who is not Underage of any item described above that is intended for the personal use of such an employee; (3) require any Participating Manufacturer to retrieve, collect or otherwise recover any item that prior to the MSA Execution Date was marketed, distributed, offered, sold, licensed, or caused to be marketed, distributed, offered, sold or licensed by such Participating Manufacturer; (4) apply to coupons or other items used by Adults solely in connection

with the purchase of Tobacco Products; or (5) apply to apparel or other merchandise used within an Adult-Only Facility that is not distributed (by sale or otherwise) to any member of the general public.

(g) *Ban on Youth Access to Free Samples.* After the MSA Execution Date, no Participating Manufacturer may, within any Settling State, distribute or cause to be distributed any free samples of Tobacco Products except in an Adult-Only Facility. For purposes of this Agreement, a "free sample" does not include a Tobacco Product that is provided to an Adult in connection with (1) the purchase, exchange or redemption for proof of purchase of any Tobacco Products (including, but not limited to, a free offer in connection with the purchase of Tobacco Products, such as a "two-for-one" offer), or (2) the conducting of consumer testing or evaluation of Tobacco Products with persons who certify that they are Adults.

(h) *Ban on Gifts to Underage Persons Based on Proofs of Purchase.* Beginning one year after the MSA Execution Date, no Participating Manufacturer may provide or cause to be provided to any person without sufficient proof that such person is an Adult any item in exchange for the purchase of Tobacco Products, or the furnishing of credits, proofs-of-purchase, or coupons with respect to such a purchase. For purposes of the preceding sentence only, (1) a driver's license or other government-issued identification (or legible photocopy thereof), the validity of which is certified by the person to whom the item is provided, shall by itself be deemed to be a sufficient form of proof of age; and (2) in the case of items provided (or to be redeemed) at retail establishments, a Participating Manufacturer shall be entitled

to rely on verification of proof of age by the retailer, where such retailer is required to obtain verification under applicable federal, state or local law.

(i) *Limitation on Third-Party Use of Brand Names.* After the MSA Execution Date, no Participating Manufacturer may license or otherwise expressly authorize any third party to use or advertise within any Settling State any Brand Name in a manner prohibited by this Agreement if done by such Participating Manufacturer itself. Each Participating Manufacturer shall, within 10 days after the MSA Execution Date, designate a person (and provide written notice to NAAG of such designation) to whom the Attorney General of any Settling State may provide written notice of any such third-party activity that would be prohibited by this Agreement if done by such Participating Manufacturer itself. Following such written notice, the Participating Manufacturer will promptly take commercially reasonable steps against any such non-de minimis third-party activity. Provided, however, that nothing in this subsection shall require any Participating Manufacturer to (1) breach or terminate any licensing agreement or other contract in existence as of July 1, 1998 (this exception shall not apply beyond the current term of any existing contract, without regard to any renewal or option term that may be exercised by such Participating Manufacturer); or (2) retrieve, collect or otherwise recover any item that prior to the MSA Execution Date was marketed, distributed, offered, sold, licensed or caused to be marketed, distributed, offered, sold or licensed by such Participating Manufacturer.

(j) *Ban on Non-Tobacco Brand Names.* No Participating Manufacturer may, pursuant to any agreement requiring the

payment of money or other valuable consideration, use or cause to be used as a brand name of any Tobacco Product any nationally recognized or nationally established brand name or trade name of any non-tobacco item or service or any nationally recognized or nationally established sports team, entertainment group or individual celebrity. Provided, however, that the preceding sentence shall not apply to any Tobacco Product brand name in existence as of July 1, 1998. For the purposes of this subsection, the term "other valuable consideration" shall not include an agreement between two entities who enter into such agreement for the sole purpose of avoiding infringement claims.

(k) *Minimum Pack Size of Twenty Cigarettes.* No Participating Manufacturer may, beginning 60 days after the MSA Execution Date and through and including December 31, 2001, manufacture or cause to be manufactured for sale in any Settling State any pack or other container of Cigarettes containing fewer than 20 Cigarettes (or, in the case of roll-your-own tobacco, any package of roll-your-own tobacco containing less than 0.60 ounces of tobacco). No Participating Manufacturer may, beginning 150 days after the MSA Execution Date and through and including December 31, 2001, sell or distribute in any Settling State any pack or other container of Cigarettes containing fewer than 20 Cigarettes (or, in the case of roll-your-own tobacco, any package of roll-your-own tobacco containing less than 0.60 ounces of tobacco). Each Participating Manufacturer further agrees that following the MSA Execution Date it shall not oppose, or cause to be opposed (including through any third party or Affiliate), the passage by any Settling State of any legislative proposal or administrative rule applicable to

all Tobacco Product Manufacturers and all retailers of Tobacco Products prohibiting the manufacture and sale of any pack or other container of Cigarettes containing fewer than 20 Cigarettes (or, in the case of roll-your-own tobacco, any package of roll-your-own tobacco containing less than 0.60 ounces of tobacco).

(l) *Corporate Culture Commitments Related to Youth Access and Consumption.* Beginning 180 days after the MSA Execution Date each Participating Manufacturer shall:

> promulgate or reaffirm corporate principles that express and explain its commitment to comply with the provisions of this Agreement and the reduction of use of Tobacco Products by Youth, and clearly and regularly communicate to its employees and customers its commitment to assist in the reduction of Youth use of Tobacco Products;
>
> designate an executive level manager (and provide written notice to NAAG of such designation) to identify methods to reduce Youth access to, and the incidence of Youth consumption of, Tobacco Products; and
>
> encourage its employees to identify additional methods to reduce Youth access to, and the incidence of Youth consumption of, Tobacco Products.

(m) *Limitations on Lobbying.* Following State-Specific Finality in a Settling State:

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No Participating Manufacturer may oppose, or cause to be opposed (including through any third party or Affiliate), the passage by such Settling State (or any political subdivision thereof) of those state or local legislative proposals or administrative rules described in Exhibit F hereto intended by their terms to reduce Youth access to, and the incidence of Youth consumption of, Tobacco Products. Provided, however, that the foregoing does not prohibit any Participating Manufacturer from (A) challenging enforcement of, or suing for declaratory or injunctive relief with respect to, any such legislation or rule on any grounds; (B) continuing, after State-Specific Finality in such Settling State, to oppose or cause to be opposed, the passage during the legislative session in which State-Specific Finality in such Settling State occurs of any specific state or local legislative proposals or administrative rules introduced prior to the time of State-Specific Finality in such Settling State; (C) opposing, or causing to be opposed, any excise tax or income tax provision or user fee or other payments relating to Tobacco Products or Tobacco Product Manufacturers; or (D) opposing, or causing to be opposed, any state or local legislative proposal or administrative rule that also includes measures other than those described in Exhibit F.

Each Participating Manufacturer shall require all of its officers and employees engaged in lobbying activities in such Settling State after

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State-Specific Finality, contract lobbyists engaged in lobbying activities in such Settling State after State-Specific Finality, and any other third parties who engage in lobbying activities in such Settling State after State-Specific Finality on behalf of such Participating Manufacturer ("lobbyist" and "lobbying activities" having the meaning such terms have under the law of the Settling State in question) to certify in writing to the Participating Manufacturer that they:

> (A) will not support or oppose any state, local or federal legislation, or seek or oppose any governmental action, on behalf of the Participating Manufacturer without the Participating Manufacturer's express authorization (except where such advance express authorization is not reasonably practicable);
>
> (B) are aware of and will fully comply with this Agreement and all laws and regulations applicable to their lobbying activities, including, without limitation, those related to disclosure of financial contributions. Provided, however, that if the Settling State in question has in existence no laws or regulations relating to disclosure of financial contributions regarding lobbying activities, then each Participating Manufacturer shall, upon request of the

Attorney General of such Settling State, disclose to such Attorney General any payment to a lobbyist that the Participating Manufacturer knows or has reason to know will be used to influence legislative or administrative actions of the state or local government relating to Tobacco Products or their use. Disclosures made pursuant to the preceding sentence shall be filed in writing with the Office of the Attorney General on the first day of February and the first day of August of each year for any and all payments made during the six month period ending on the last day of the preceding December and June, respectively, with the following information: (1) the name, address, telephone number and e-mail address (if any) of the recipient; (2) the amount of each payment; and (3) the aggregate amount of all payments described in this subsection (2)(B) to the recipient in the calendar year; and

(C) have reviewed and will fully abide by the Participating Manufacturer's corporate principles promulgated pursuant to this Agreement when acting on behalf of the Participating Manufacturer.

No Participating Manufacturer may support or cause to be supported (including through any third party or Affiliate) in Congress or any other

forum legislation or rules that would preempt, override, abrogate or diminish such Settling State's rights or recoveries under this Agreement. Except as specifically provided in this Agreement, nothing herein shall be deemed to restrain any Settling State or Participating Manufacturer from advocating terms of any national settlement or taking any other positions on issues relating to tobacco.

(n) *Restriction on Advocacy Concerning Settlement Proceeds.* After the MSA Execution Date, no Participating Manufacturer may support or cause to be supported (including through any third party or Affiliate) the diversion of any proceeds of this settlement to any program or use that is neither tobacco-related nor health-related in connection with the approval of this Agreement or in any subsequent legislative appropriation of settlement proceeds.

(o) *Dissolution of The Tobacco Institute, Inc., the Council for Tobacco Research-U.S.A., Inc. and the Center for Indoor Air Research, Inc.*

(1) The Council for Tobacco Research-U.S.A., Inc. ("CTR") (a not-for-profit corporation formed under the laws of the State of New York) shall, pursuant to the plan of dissolution previously negotiated and agreed to between the Attorney General of the State of New York and CTR, cease all operations and be dissolved in accordance with the laws of the State of New York (and with the preservation of all applicable privileges held by any member company of CTR).

(2) The Tobacco Institute, Inc. ("TI") (a not-for-profit corporation formed under the laws of the State of New York) shall, pursuant to a plan of dissolution to be negotiated by the Attorney General of the State of New York and the Original Participating Manufacturers in accordance with Exhibit G hereto, cease all operations and be dissolved in accordance with the laws of the State of New York and under the authority of the Attorney General of the State of New York (and with the preservation of all applicable privileges held by any member company of TI).

(3) Within 45 days after Final Approval, the Center for Indoor Air Research, Inc., ("CIAR") shall cease all operations and be dissolved in a manner consistent with applicable law and with the preservation of all applicable privileges (including, without limitation, privileges held by any member company of CIAR).

(4) The Participating Manufacturers shall direct the Tobacco-Related Organizations to preserve all records that relate in any way to issues raised in smoking-related health litigation.

(5) The Participating Manufacturers may not reconstitute CTR or its function in any form.

(6) The Participating Manufacturers represent that they have the authority to and will effectuate subsections (1) through (5) hereof.

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(p) *Regulation and Oversight of New Tobacco-Related Trade Associations.*

(1) A Participating Manufacturer may form or participate in new tobacco-related trade associations (subject to all applicable laws), provided such associations agree in writing not to act in any manner contrary to any provision of this Agreement. Each Participating Manufacturer agrees that if any new tobacco-related trade association fails to so agree, such Participating Manufacturer will not participate in or support such association.

(2) Any tobacco-related trade association that is formed or controlled by one or more of the Participating Manufacturers after the MSA Execution Date shall adopt by-laws governing the association's procedures and the activities of its members, board, employees, agents and other representatives with respect to the tobacco-related trade association. Such by-laws shall include, among other things, provisions that:

(A) each officer of the association shall be appointed by the board of the association, shall be an employee of such association, and during such officer's term shall not be a director of or employed by any member of the association or by an Affiliate of any member of the association;

(B) legal counsel for the association shall be independent, and neither counsel nor any member or employee of counsel's law firm shall serve as legal counsel to any member of the association or to a manufacturer of Tobacco Products that is an Affiliate of any member of the association during the time that it is serving as legal counsel to the association; and

(C) minutes describing the substance of the meetings of the board of directors of the association shall be prepared and shall be maintained by the association for a period of at least five years following their preparation.

(3) Without limitation on whatever other rights to access they may be permitted by law, for a period of seven years from the date any new tobacco-related trade association is formed by any of the Participating Manufacturers after the MSA Execution Date the antitrust authorities of any Settling State may, for the purpose of enforcing this Agreement, upon reasonable cause to believe that a violation of this Agreement has occurred, and upon reasonable prior written notice (but in no event less than 10 Business Days):

(A) have access during regular office hours to inspect and copy all relevant non-privileged, non-work-product books,

records, meeting agenda and minutes, and other documents (whether in hard copy form or stored electronically) of such association insofar as they pertain to such believed violation; and

(B) interview the association's directors, officers and employees (who shall be entitled to have counsel present) with respect to relevant, non-privileged, non-work-product matters pertaining to such believed violation.

Documents and information provided to Settling State antitrust authorities shall be kept confidential by and among such authorities, and shall be utilized only by the Settling States and only for the purpose of enforcing this Agreement or the criminal law. The inspection and discovery rights provided to the Settling States pursuant to this subsection shall be coordinated so as to avoid repetitive and excessive inspection and discovery.

(q) *Prohibition on Agreements to Suppress Research.* No Participating Manufacturer may enter into any contract, combination or conspiracy with any other Tobacco Product Manufacturer that has the purpose or effect of: (1) limiting competition in the production or distribution of information about health hazards or other consequences of the use of their products; (2) limiting or suppressing research into smoking and health; or (3) limiting or suppressing research into the marketing or development of new products. Provided, however, that nothing in this subsection shall be deemed to (1) require any Participating Manufacturer to produce, distribute or

otherwise disclose any information that is subject to any privilege or protection; (2) preclude any Participating Manufacturer from entering into any joint defense or joint legal interest agreement or arrangement (whether or not in writing), or from asserting any privilege pursuant thereto; or (3) impose any affirmative obligation on any Participating Manufacturer to conduct any research.

(r) *Prohibition on Material Misrepresentations.* No Participating Manufacturer may make any material misrepresentation of fact regarding the health consequences of using any Tobacco Product, including any tobacco additives, filters, paper or other ingredients. Nothing in this subsection shall limit the exercise of any First Amendment right or the assertion of any defense or position in any judicial, legislative or regulatory forum.

* * *

VII. ENFORCEMENT

* * *

(c) *Enforcement of this Agreement.*

(1) Except as provided in subsections IX(d), XI(c), XVII(d) and Exhibit O, any Settling State or Participating Manufacturer may bring an action in the Court to enforce the terms of this Agreement (or for a declaration construing any such term ("Declaratory Order")) with respect to disputes, alleged violations or alleged breaches within such Settling State.

(2) Before initiating such proceedings, a party shall provide 30 days' written notice to the Attorney General of each Settling State, to NAAG, and to each Participating Manufacturer of its intent to initiate proceedings pursuant to this subsection. The 30-day notice period may be shortened in the event that the relevant Attorney General reasonably determines that a compelling time-sensitive public health and safety concern requires more immediate action.

(3) In the event that the Court determines that any Participating Manufacturer or Settling State has violated or breached this Agreement, the party that initiated the proceedings may request an order restraining such violation or breach, and/or ordering compliance within such Settling State (an "Enforcement Order").

(4) If an issue arises as to whether a Participating Manufacturer has failed to comply with an Enforcement Order, the Attorney General for the Settling State in question may seek an order for interpretation or for monetary, civil contempt or criminal sanctions to enforce compliance with such Enforcement Order.

(5) If the Court finds that a good-faith dispute exists as to the meaning of the terms of this Agreement or a Declaratory Order, the Court may in its discretion determine to enter a Declaratory Order rather than an Enforcement Order.

(6) Whenever possible, the parties shall seek to resolve an alleged violation of this Agreement by discussion pursuant to subsection XVIII(m) of this Agreement. In addition, in determining whether to seek an Enforcement Order, or in determining whether to seek an order for monetary, civil contempt or criminal sanctions for any claimed violation of an Enforcement Order, the Attorney General shall give good-faith consideration to whether the Participating Manufacturer that is claimed to have violated this Agreement has taken appropriate and reasonable steps to cause the claimed violation to be cured, unless such party has been guilty of a pattern of violations of like nature.

(d) *Right of Review*. All orders and other judicial determinations made by any court in connection with this Agreement or any Consent Decree shall be subject to all available appellate review, and nothing in this Agreement or any Consent Decree shall be deemed to constitute a waiver of any right to any such review.

(e) *Applicability*. This Agreement and the Consent Decree apply only to the Participating Manufacturers in their corporate capacity acting through their respective successors and assigns, directors, officers, employees, agents, subsidiaries, divisions, or other internal organizational units of any kind or any other entities acting in concert or participation with them. The remedies, penalties and sanctions that may be imposed or assessed in connection with a breach or violation of this Agreement or the Consent Decree

(or any Declaratory Order or Enforcement Order issued in connection with this Agreement or the Consent Decree) shall only apply to the Participating Manufacturers, and shall not be imposed or assessed against any employee, officer or director of any Participating Manufacturer, or against any other person or entity as a consequence of such breach or violation, and the Court shall have no jurisdiction to do so.

* * *

IX. PAYMENTS

(a) *All Payments Into Escrow.* All payments made pursuant to this Agreement (except those payments made pursuant to section XVII) shall be made into escrow pursuant to the Escrow Agreement, and shall be credited to the appropriate Account established pursuant to the Escrow Agreement. Such payments shall be disbursed to the beneficiaries or returned to the Participating Manufacturers only as provided in section XI and the Escrow Agreement. No payment obligation under this Agreement shall arise (1) unless and until the Escrow Court has approved and retained jurisdiction over the Escrow Agreement or (2) if such approval is reversed (unless and until such reversal is itself reversed). The parties agree to proceed as expeditiously as possible to resolve any issues that prevent approval of the Escrow Agreement. If any payment (other than the first initial payment under subsection IX(b)) is delayed because the Escrow Agreement has not been approved, such payment shall be due and payable (together with interest at the Prime Rate) within 10 Business Days after approval of the Escrow Agreement by the Escrow Court.

(b) *Initial Payments*. On the second Business Day after the Escrow Court approves and retains jurisdiction over the Escrow Agreement, each Original Participating Manufacturer shall severally pay to the Escrow Agent (to be credited to the Subsection IX(b) Account (First)) its Market Capitalization Percentage (as set forth in Exhibit K) of the base amount of $2,400,000,000. On January 10, 2000, each Original Participating Manufacturer shall severally pay to the Escrow Agent its Relative Market Share of the base amount of $2,472,000,000. On January 10, 2001, each Original Participating Manufacturer shall severally pay to the Escrow Agent its Relative Market Share of the base amount of $2,546,160,000. On January 10, 2002, each Original Participating Manufacturer shall severally pay to the Escrow Agent its Relative Market Share of the base amount of $2,622,544,800. On January 10, 2003, each Original Participating Manufacturer shall severally pay to the Escrow Agent its Relative Market Share of the base amount of $2,701,221,144. The payments pursuant to this subsection (b) due on or after January 10, 2000 shall be credited to the Subsection IX(b) Account (Subsequent). The foregoing payments shall be modified in accordance with this subsection (b). The payments made by the Original Participating Manufacturers pursuant to this subsection (b) (other than the first such payment) shall be subject to the Volume Adjustment, the Non-Settling States Reduction and the offset for miscalculated or disputed payments described in subsection XI(i). The first payment due under this subsection (b) shall be subject to the Non-Settling States Reduction, but such reduction shall be determined as of the date one day before such payment is due (rather than the date 15 days before).

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(c) *Annual Payments and Strategic Contribution Payments.*

(1) On April 15, 2000 and on April 15 of each year thereafter in perpetuity, each Original Participating Manufacturer shall severally pay to the Escrow Agent (to be credited to the Subsection IX(c)(1) Account) its Relative Market Share of the base amounts specified below, as such payments are modified in accordance with this subsection (c)(1):

Year	Base Amount
2000	$4,500,000,000
2001	$5,000,000,000
2002	$6,500,000,000
2003	$6,500,000,000
2004	$8,000,000,000
2005	$8,000,000,000
2006	$8,000,000,000
2007	$8,000,000,000
2008	$8,139,000,000
2009	$8,139,000,000
2010	$8,139,000,000
2011	$8,139,000,000
2012	$8,139,000,000
2013	$8,139,000,000
2014	$8,139,000,000
2015	$8,139,000,000
2016	$8,139,000,000
2017	$8,139,000,000
2018 and each year thereafter	$9,000,000,000

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The payments made by the Original Participating Manufacturers pursuant to this subsection (c)(1) shall be subject to the Inflation Adjustment, the Volume Adjustment, the Previously Settled States Reduction, the Non-Settling States Reduction, the NPM Adjustment, the offset for miscalculated or disputed payments described in subsection XI(i), the Federal Tobacco Legislation Offset, the Litigating Releasing Parties Offset, and the offsets for claims over described in subsections XII(a)(4)(B) and XII(a)(8).

(2) On April 15, 2008 and on April 15 of each year thereafter through 2017, each Original Participating Manufacturer shall severally pay to the Escrow Agent (to be credited to the Subsection IX(c)(2) Account) its Relative Market Share of the base amount of $861,000,000, as such payments are modified in accordance with this subsection (c)(2). The payments made by the Original Participating Manufacturers pursuant to this subsection (c)(2) shall be subject to the Inflation Adjustment, the Volume Adjustment, the NPM Adjustment, the offset for miscalculated or disputed payments described in subsection XI(i), the Federal Tobacco Legislation Offset, the Litigating Releasing Parties Offset, and the offsets for claims over described in subsections XII(a)(4)(B) and XII(a)(8). Such payments shall also be subject to the Non-Settling States Reduction; provided, however, that for purposes of payments due pursuant to this subsection (c)(2)

(and corresponding payments by Subsequent Participating Manufacturers under subsection IX(i)), the Non-Settling States Reduction shall be derived as follows: (A) the payments made by the Original Participating Manufacturers pursuant to this subsection (c)(2) shall be allocated among the Settling States on a percentage basis to be determined by the Settling States pursuant to the procedures set forth in Exhibit U, and the resulting allocation percentages disclosed to the Escrow Agent, the Independent Auditor and the Original Participating Manufacturers not later than June 30, 1999; and (B) the Non-Settling States Reduction shall be based on the sum of the Allocable Shares so established pursuant to subsection (c)(2)(A) for those States that were Settling States as of the MSA Execution Date and as to which this Agreement has terminated as of the date 15 days before the payment in question is due.

(d) *Non-Participating Manufacturer Adjustment.*

(1) *Calculation of NPM Adjustment for Original Participating Manufacturers.* To protect the public health gains achieved by this Agreement, certain payments made pursuant to this Agreement shall be subject to an NPM Adjustment. Payments by the Original Participating Manufacturers to which the NPM Adjustment applies shall be adjusted as provided below:

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(A) Subject to the provisions of subsections (d)(1)(C), (d)(1)(D) and (d)(2) below, each Allocated Payment shall be adjusted by subtracting from such Allocated Payment the product of such Allocated Payment amount multiplied by the NPM Adjustment Percentage. The "NPM Adjustment Percentage" shall be calculated as follows:

(i) If the Market Share Loss for the year immediately preceding the year in which the payment in question is due is less than or equal to 0 (zero), then the NPM Adjustment Percentage shall equal zero.

(ii) If the Market Share Loss for the year immediately preceding the year in which the payment in question is due is greater than 0 (zero) and less than or equal to 16 2/3 percentage points, then the NPM Adjustment Percentage shall be equal to the product of (x) such Market Share Loss and (y) 3 (three).

(iii) If the Market Share Loss for the year immediately preceding the year in which the payment in question is due is greater than 16 2/3 percentage points, then the NPM

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Adjustment Percentage shall be equal to the sum of (x) 50 percentage points and (y) the product of (*1*) the Variable Multiplier and (*2*) the result of such Market Share Loss minus 16 2/3 percentage points.

(B) Definitions:

(i) "Base Aggregate Participating Manufacturer Market Share" means the result of (x) the sum of the applicable Market Shares (the applicable Market Share to be that for 1997) of all present and former Tobacco Product Manufacturers that were Participating Manufacturers during the entire calendar year immediately preceding the year in which the payment in question is due minus (y) 2 (two) percentage points.

(ii) "Actual Aggregate Participating Manufacturer Market Share" means the sum of the applicable Market Shares of all present and former Tobacco Product Manufacturers that were Participating Manufacturers during the entire calendar year immediately preceding the year in which the payment in question is due (the applicable

Market Share to be that for the calendar year immediately preceding the year in which the payment in question is due).

(iii) "Market Share Loss" means the result of (x) the Base Aggregate Participating Manufacturer Market Share minus (y) the Actual Aggregate Participating Manufacturer Market Share.

(iv) "Variable Multiplier" equals 50 percentage points divided by the result of (x) the Base Aggregate Participating Manufacturer Market Share minus (y) 16 2/3 percentage points.

(C) On or before February 2 of each year following a year in which there was a Market Share Loss greater than zero, a nationally recognized firm of economic consultants (the "Firm") shall determine whether the disadvantages experienced as a result of the provisions of this Agreement were a significant factor contributing to the Market Share Loss for the year in question. If the Firm determines that the disadvantages experienced as a result of the provisions of this Agreement were a significant

factor contributing to the Market Share Loss for the year in question, the NPM Adjustment described in subsection IX(d)(1) shall apply. If the Firm determines that the disadvantages experienced as a result of the provisions of this Agreement were not a significant factor contributing to the Market Share Loss for the year in question, the NPM Adjustment described in subsection IX(d)(1) shall not apply. The Original Participating Manufacturers, the Settling States, and the Attorneys General for the Settling States shall cooperate to ensure that the determination described in this subsection (1)(C) is timely made. The Firm shall be acceptable to (and the principals responsible for this assignment shall be acceptable to) both the Original Participating Manufacturers and a majority of those Attorneys General who are both the Attorney General of a Settling State and a member of the NAAG executive committee at the time in question (or in the event no such firm or no such principals shall be acceptable to such parties, National Economic Research Associates, Inc., or its successors by merger, acquisition or otherwise ("NERA"), acting through a principal or principals acceptable to such parties, if such a person can be identified and,

if not, acting through a principal or principals identified by NERA, or a successor firm selected by the CPR Institute for Dispute Resolution). As soon as practicable after the MSA Execution Date, the Firm shall be jointly retained by the Settling States and the Original Participating Manufacturers for the purpose of making the foregoing determination, and the Firm shall provide written notice to each Settling State, to NAAG, to the Independent Auditor and to each Participating Manufacturer of such determination. The determination of the Firm with respect to this issue shall be conclusive and binding upon all parties, and shall be final and non-appealable. The reasonable fees and expenses of the Firm shall be paid by the Original Participating Manufacturers according to their Relative Market Shares. Only the Participating Manufacturers and the Settling States, and their respective counsel, shall be entitled to communicate with the Firm with respect to the Firm's activities pursuant to this subsection (1)(C).

(D) No NPM Adjustment shall be made with respect to a payment if the aggregate number of Cigarettes shipped in or to the fifty United States, the District of Columbia and Puerto Rico

in the year immediately preceding the year in which the payment in question is due by those Participating Manufacturers that had become Participating Manufacturers prior to 14 days after the MSA Execution Date is greater than the aggregate number of Cigarettes shipped in or to the fifty United States, the District of Columbia, and Puerto Rico in 1997 by such Participating Manufacturers (and any of their Affiliates that made such shipments in 1997, as demonstrated by certified audited statements of such Affiliates' shipments, and that do not continue to make such shipments after the MSA Execution Date because the responsibility for such shipments has been transferred to one of such Participating Manufacturers). Measurements of shipments for purposes of this subsection (D) shall be made in the manner prescribed in subsection II(mm); in the event that such shipment data is unavailable for any Participating Manufacturer for 1997, such Participating Manufacturer's shipment volume for such year shall be measured in the manner prescribed in subsection II(z).

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(2) *Allocation among Settling States of NPM Adjustment for Original Participating Manufacturers.*

(A) The NPM Adjustment set forth in subsection (d)(1) shall apply to the Allocated Payments of all Settling States, except as set forth below.

(B) A Settling State's Allocated Payment shall not be subject to an NPM Adjustment: (i) if such Settling State continuously had a Qualifying Statute (as defined in subsection (2)(E) below) in full force and effect during the entire calendar year immediately preceding the year in which the payment in question is due, and diligently enforced the provisions of such statute during such entire calendar year; or (ii) if such Settling State enacted the Model Statute (as defined in subsection (2)(E) below) for the first time during the calendar year immediately preceding the year in which the payment in question is due, continuously had the Model Statute in full force and effect during the last six months of such calendar year, and diligently enforced the provisions of such statute during the period in which it was in full force and effect.

(C) The aggregate amount of the NPM Adjustments that would have

applied to the Allocated Payments of those Settling States that are not subject to an NPM Adjustment pursuant to subsection (2)(B) shall be reallocated among all other Settling States pro rata in proportion to their respective Allocable Shares (the applicable Allocable Shares being those listed in Exhibit A), and such other Settling States' Allocated Payments shall be further reduced accordingly.

(D) This subsection (2)(D) shall apply if the amount of the NPM Adjustment applied pursuant to subsection (2)(A) to any Settling State plus the amount of the NPM Adjustments reallocated to such Settling State pursuant to subsection (2)(C) in any individual year would either (i) exceed such Settling State's Allocated Payment in that year, or (ii) if subsection (2)(F) applies to the Settling State in question, exceed 65% of such Settling State's Allocated Payment in that year. For each Settling State that has an excess as described in the preceding sentence, the excess amount of NPM Adjustment shall be further reallocated among all other Settling States whose Allocated Payments are subject to an NPM Adjustment and that do not have such an excess, pro rata in proportion to their

respective Allocable Shares, and such other Settling States' Allocated Payments shall be further reduced accordingly. The provisions of this subsection (2)(D) shall be repeatedly applied in any individual year until either (i) the aggregate amount of NPM Adjustments has been fully reallocated or (ii) the full amount of the NPM Adjustments subject to reallocation under subsection (2)(C) or (2)(D) cannot be fully reallocated in any individual year as described in those subsections because (x) the Allocated Payment in that year of each Settling State that is subject to an NPM Adjustment and to which subsection (2)(F) does not apply has been reduced to zero, and (y) the Allocated Payment in that year of each Settling State to which subsection (2)(F) applies has been reduced to 35% of such Allocated Payment.

(E) A "Qualifying Statute" means a Settling State's statute, regulation, law and/or rule (applicable everywhere the Settling State has authority to legislate) that effectively and fully neutralizes the cost disadvantages that the Participating Manufacturers experience vis-à-vis Non-Participating Manufacturers within such Settling State as a result of the provisions of this Agreement. Each

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Participating Manufacturer and each Settling State agree that the model statute in the form set forth in Exhibit T (the "Model Statute"), if enacted without modification or addition (except for particularized state procedural or technical requirements) and not in conjunction with any other legislative or regulatory proposal, shall constitute a Qualifying Statute. Each Participating Manufacturer agrees to support the enactment of such Model Statute if such Model Statute is introduced or proposed (i) without modification or addition (except for particularized procedural or technical requirements), and (ii) not in conjunction with any other legislative proposal.

(F) If a Settling State (i) enacts the Model Statute without any modification or addition (except for particularized state procedural or technical requirements) and not in conjunction with any other legislative or regulatory proposal, (ii) uses its best efforts to keep the Model Statute in full force and effect by, among other things, defending the Model Statute fully in any litigation brought in state or federal court within such Settling State (including litigating all available appeals that may affect the effectiveness of the Model Statute), and (iii) otherwise

complies with subsection (2)(B), but a court of competent jurisdiction nevertheless invalidates or renders unenforceable the Model Statute with respect to such Settling State, and but for such ruling the Settling State would have been exempt from an NPM Adjustment under subsection (2)(B), then the NPM Adjustment (including reallocations pursuant to subsections (2)(C) and (2)(D)) shall still apply to such Settling State's Allocated Payments but in any individual year shall not exceed 65% of the amount of such Allocated Payments.

(G) In the event a Settling State proposes and/or enacts a statute, regulation, law and/or rule (applicable everywhere the Settling State has authority to legislate) that is not the Model Statute and asserts that such statute, regulation, law and/or rule is a Qualifying Statute, the Firm shall be jointly retained by the Settling States and the Original Participating Manufacturers for the purpose of determining whether or not such statute, regulation, law and/or rule constitutes a Qualifying Statute. The Firm shall make the foregoing determination within 90 days of a written request to it from the relevant Settling State (copies of which request the Settling State shall also

provide to all Participating Manufacturers and the Independent Auditor), and the Firm shall promptly thereafter provide written notice of such determination to the relevant Settling State, NAAG, all Participating Manufacturers and the Independent Auditor. The determination of the Firm with respect to this issue shall be conclusive and binding upon all parties, and shall be final and non-appealable; provided, however, (i) that such determination shall be of no force and effect with respect to a proposed statute, regulation, law and/or rule that is thereafter enacted with any modification or addition; and (ii) that the Settling State in which the Qualifying Statute was enacted and any Participating Manufacturer may at any time request that the Firm reconsider its determination as to this issue in light of subsequent events (including, without limitation, subsequent judicial review, interpretation, modification and/or disapproval of a Settling State's Qualifying Statute, and the manner and/or the effect of enforcement of such Qualifying Statute). The Original Participating Manufacturers shall severally pay their Relative Market Shares of the reasonable fees and expenses of the Firm. Only the Participating Manufacturers and Settling States, and their respective counsel,

shall be entitled to communicate with the Firm with respect to the Firm's activities pursuant to this subsection (2)(G).

(H) Except as provided in subsection (2)(F), in the event a Qualifying Statute is enacted within a Settling State and is thereafter invalidated or declared unenforceable by a court of competent jurisdiction, otherwise rendered not in full force and effect, or, upon reconsideration by the Firm pursuant to subsection (2)(G) determined not to constitute a Qualifying Statute, then such Settling State's Allocated Payments shall be fully subject to an NPM Adjustment unless and until the requirements of subsection (2)(B) have been once again satisfied.

(3) *Allocation of NPM Adjustment among Original Participating Manufacturers*. The portion of the total amount of the NPM Adjustment to which the Original Participating Manufacturers are entitled in any year that can be applied in such year consistent with subsection IX(d)(2) (the "Available NPM Adjustment") shall be allocated among them as provided in this subsection IX(d)(3).

Appendix E

(A) The "Base NPM Adjustment" shall be determined for each Original Participating Manufacturer in such year as follows:

(i) For those Original Participating Manufacturers whose Relative Market Shares in the year immediately preceding the year in which the NPM Adjustment in question is applied exceed or are equal to their respective 1997 Relative Market Shares, the Base NPM Adjustment shall equal 0 (zero).

(ii) For those Original Participating Manufacturers whose Relative Market Shares in the year immediately preceding the year in which the NPM Adjustment in question is applied are less than their respective 1997 Relative Market Shares, the Base NPM Adjustment shall equal the result of (x) the difference between such Original Participating Manufacturer's Relative Market Share in such preceding year and its 1997 Relative Market Share multiplied by both (y) the number of individual Cigarettes (expressed in thousands of units) shipped in or to the United States,

the District of Columbia and Puerto Rico by all the Original Participating Manufacturers in such preceding year (determined in accordance with subsection II(mm)) and (z) $20 per each thousand units of Cigarettes (as this number is adjusted pursuant to subsection IX(d)(3)(C) below).

(iii) For those Original Participating Manufacturers whose Base NPM Adjustment, if calculated pursuant to subsection (ii) above, would exceed $300 million (as this number is adjusted pursuant to subsection IX(d)(3)(C) below), the Base NPM Adjustment shall equal $300 million (or such adjusted number, as provided in subsection IX(d)(3)(C) below).

(B) The share of the Available NPM Adjustment each Original Participating Manufacturer is entitled to shall be calculated as follows:

(i) If the Available NPM Adjustment the Original Participating Manufacturers are entitled to in any year is less than or equal to the sum of the Base NPM Adjustments of all Original Participating Manufacturers

in such year, then such Available NPM Adjustment shall be allocated among those Original Participating Manufacturers whose Base NPM Adjustment is not equal to 0 (zero) pro rata in proportion to their respective Base NPM Adjustments.

(ii) If the Available NPM Adjustment the Original Participating Manufacturers are entitled to in any year exceeds the sum of the Base NPM Adjustments of all Original Participating Manufacturers in such year, then (x) the difference between such Available NPM Adjustment and such sum of the Base NPM Adjustments shall be allocated among the Original Participating Manufacturers pro rata in proportion to their Relative Market Shares (the applicable Relative Market Shares to be those in the year immediately preceding such year), and (y) each Original Participating Manufacturer's share of such Available NPM Adjustment shall equal the sum of *(1)* its Base NPM Adjustment for such year, and *(2)* the amount allocated to such Original Participating Manufacturer pursuant to clause (x).

(iii) If an Original Participating Manufacturer's share of the Available NPM Adjustment calculated pursuant to subsection IX(d)(3)(B)(i) or IX(d)(3)(B)(ii) exceeds such Original Participating Manufacturer's payment amount to which such NPM Adjustment applies (as such payment amount has been determined pursuant to step B of clause "Seventh" of subsection IX(j)), then *(1)* such Original Participating Manufacturer's share of the Available NPM Adjustment shall equal such payment amount, and *(2)* such excess shall be reallocated among the other Original Participating Manufacturers pro rata in proportion to their Relative Market Shares.

(C) Adjustments:

(i) For calculations made pursuant to this subsection IX(d)(3) (if any) with respect to payments due in the year 2000, the number used in subsection IX(d)(3)(A)(ii)(z) shall be $20 and the number used in subsection IX(d)(3)(A)(iii) shall be $300 million. Each year thereafter, both these numbers shall be adjusted

upward or downward by multiplying each of them by the quotient produced by dividing (x) the average revenue per Cigarette of all the Original Participating Manufacturers in the year immediately preceding such year, by (y) the average revenue per Cigarette of all the Original Participating Manufacturers in the year immediately preceding such immediately preceding year.

(ii) For purposes of this subsection, the average revenue per Cigarette of all the Original Participating Manufacturers in any year shall equal (x) the aggregate revenues of all the Original Participating Manufacturers from sales of Cigarettes in the fifty United States, the District of Columbia and Puerto Rico after Federal excise taxes and after payments pursuant to this Agreement and the tobacco litigation Settlement Agreements with the States of Florida, Mississippi, Minnesota and Texas (as such revenues are reported to the United States Securities and Exchange Commission ("SEC") for such year (either independently by the Original Participating Manufacturer or as part

of consolidated financial statements reported to the SEC by an Affiliate of the Original Participating Manufacturers) or, in the case of an Original Participating Manufacturer that does not report income to the SEC, as reported in financial statements prepared in accordance with United States generally accepted accounting principles and audited by a nationally recognized accounting firm), divided by (y) the aggregate number of the individual Cigarettes shipped in or to the United States, the District of Columbia and Puerto Rico by all the Original Participating Manufacturers in such year (determined in accordance with subsection II(mm)).

(D) In the event that in the year immediately preceding the year in which the NPM Adjustment in question is applied both (x) the Relative Market Share of Lorillard Tobacco Company (or of its successor) ("Lorillard") was less than or equal to 20.0000000%, and (y) the number of individual Cigarettes shipped in or to the United States, the District of Columbia and Puerto Rico by Lorillard (determined in accordance with subsection II(mm)) (for purposes

of this subsection (D), "Volume") was less than or equal to 70 billion, Lorillard's and Philip Morris Incorporated's (or its successor's) ("Philip Morris") shares of the Available NPM Adjustment calculated pursuant to subsections (3)(A)-(C) above shall be further reallocated between Lorillard and Philip Morris as follows (this subsection (3)(D) shall not apply in the year in which either of the two conditions specified in this sentence is not satisfied):

> (i) Notwithstanding subsections (A)-(C) of this subsection (d)(3), but subject to further adjustment pursuant to subsections (D)(ii) and (D)(iii) below, Lorillard's share of the Available NPM Adjustment shall equal its Relative Market Share of such Available NPM Adjustment (the applicable Relative Market Share to be that in the year immediately preceding the year in which such NPM Adjustment is applied). The dollar amount of the difference between the share of the Available NPM Adjustment Lorillard is entitled to pursuant to the preceeding sentence and the share of the Available NPM Adjustment it would be entitled to in the same

year pursuant to subsections (d)(3)(A)-(C) shall be reallocated to Philip Morris and used to decrease or increase, as the case may be, Philip Morris's share of the Available NPM Adjustment in such year calculated pursuant to subsections (d)(3)(A)-(C).

(ii) In the event that in the year immediately preceding the year in which the NPM Adjustment in question is applied either (x) Lorillard's Relative Market Share was greater than 15.0000000% (but did not exceed 20.0000000%), or (y) Lorillard's Volume was greater than 50 billion (but did not exceed 70 billion), or both, Lorillard's share of the Available NPM Adjustment calculated pursuant to subsection (d)(3)(D)(i) shall be reduced by a percentage equal to the greater of (*1*) 10.0000000% for each percentage point (or fraction thereof) of excess of such Relative Market Share over 15.0000000% (if any), or (*2*) 2.5000000% for each billion (or fraction thereof) of excess of such Volume over 50 billion (if any). The dollar amount by which Lorillard's share of the Available NPM

Adjustment is reduced in any year pursuant to this subsection (D)(ii) shall be reallocated to Philip Morris and used to increase Philip Morris's share of the Available NPM Adjustment in such year.

In the event that in any year a reallocation of the shares of the Available NPM Adjustment between Lorillard and Philip Morris pursuant to this subsection (d)(3)(D) results in Philip Morris's share of the Available NPM Adjustment in such year exceeding the greater of (x) Philip Morris's Relative Market Share of such Available NPM Adjustment (the applicable Relative Market Share to be that in the year immediately preceding such year), or (y) Philip Morris's share of the Available NPM Adjustment in such year calculated pursuant to subsections (d)(3)(A)-(C), Philip Morris's share of the Available NPM Adjustment in such year shall be reduced to equal the greater of (x) or (y) above. In such instance, the dollar amount by which Philip Morris's share of the Available NPM Adjustment is reduced pursuant to the preceding sentence shall be

reallocated to Lorillard and used to increase Lorillard's share of the Available NPM Adjustment in such year.

(iv) In the event that either Philip Morris or Lorillard is treated as a Non-Participating Manufacturer for purposes of this subsection IX(d)(3) pursuant to subsection XVIII(w)(2)(A), this subsection (3)(D) shall not be applied, and the Original Participating Manufacturers' shares of the Available NPM Adjustment shall be determined solely as described in subsections (3)(A)-(C).

(4) *NPM Adjustment for Subsequent Participating Manufacturers*. Subject to the provisions of subsection IX(i)(3), a Subsequent Participating Manufacturer shall be entitled to an NPM Adjustment with respect to payments due from such Subsequent Participating Manufacturer in any year during which an NPM Adjustment is applicable under subsection (d)(1) above to payments due from the Original Participating Manufacturers. The amount of such NPM Adjustment shall equal the product of (A) the NPM Adjustment Percentage for such year multiplied by (B) the sum of the payments due in the year in question from such Subsequent Participating Manufacturer that correspond to payments due from Original Participating

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Manufacturers pursuant to subsection IX(c) (as such payment amounts due from such Subsequent Participating Manufacturer have been adjusted and allocated pursuant to clauses "First" through "Fifth" of subsection IX(j)). The NPM Adjustment to payments by each Subsequent Participating Manufacturer shall be allocated and reallocated among the Settling States in a manner consistent with subsection (d)(2) above.

(e) *Supplemental Payments.* Beginning on April 15, 2004, and on April 15 of each year thereafter in perpetuity, in the event that the sum of the Market Shares of the Participating Manufacturers that were Participating Manufacturers during the entire calendar year immediately preceding the year in which the payment in question would be due (the applicable Market Share to be that for the calendar year immediately preceding the year in which the payment in question would be due) equals or exceeds 99.0500000%, each Original Participating Manufacturer shall severally pay to the Escrow Agent (to be credited to the Subsection IX(e) Account) for the benefit of the Foundation its Relative Market Share of the base amount of $300,000,000, as such payments are modified in accordance with this subsection (e). Such payments shall be utilized by the Foundation to fund the national public education functions of the Foundation described in subsection VI(f)(1), in the manner described in and subject to the provisions of subsections VI(g) and VI(h). The payments made by the Original Participating Manufacturers pursuant to this subsection shall be subject to the Inflation Adjustment, the Volume Adjustment, the Non-Settling States Reduction, and the offset for miscalculated or disputed payments described in subsection XI(i).

(f) *Payment Responsibility*. The payment obligations of each Participating Manufacturer pursuant to this Agreement shall be the several responsibility only of that Participating Manufacturer. The payment obligations of a Participating Manufacturer shall not be the obligation or responsibility of any Affiliate of such Participating Manufacturer. The payment obligations of a Participating Manufacturer shall not be the obligation or responsibility of any other Participating Manufacturer. Provided, however, that no provision of this Agreement shall waive or excuse liability under any state or federal fraudulent conveyance or fraudulent transfer law. Any Participating Manufacturer whose Market Share (or Relative Market Share) in any given year equals zero shall have no payment obligations under this Agreement in the succeeding year.

(g) *Corporate Structures*. Due to the particular corporate structures of R.J. Reynolds Tobacco Company ("Reynolds") and Brown & Williamson Tobacco Corporation ("B&W") with respect to their non-domestic tobacco operations, Reynolds and B&W shall be severally liable for their respective shares of each payment due pursuant to this Agreement up to (and their liability hereunder shall not exceed) the full extent of their assets used in and earnings derived from, the manufacture and/or sale in the States of Tobacco Products intended for domestic consumption, and no recourse shall be had against any of their other assets or earnings to satisfy such obligations.

(h) *Accrual of Interest*. Except as expressly provided otherwise in this Agreement, any payment due hereunder and not paid when due (or payments requiring the accrual of

interest under subsection XI(d)) shall accrue interest from and including the date such payment is due until (but not including) the date paid at the Prime Rate plus three percentage points.

(i) *Payments by Subsequent Participating Manufacturers.*

(1) A Subsequent Participating Manufacturer shall have payment obligations under this Agreement only in the event that its Market Share in any calendar year exceeds the greater of *(1)* its 1998 Market Share or *(2)* 125 percent of its 1997 Market Share (subject to the provisions of subsection (i)(4)). In the year following any such calendar year, such Subsequent Participating Manufacturer shall make payments corresponding to those due in that same following year from the Original Participating Manufacturers pursuant to subsections VI(c) (except for the payment due on March 31, 1999), IX(c)(1), IX(c)(2) and IX(e). The amounts of such corresponding payments by a Subsequent Participating Manufacturer are in addition to the corresponding payments that are due from the Original Participating Manufacturers and shall be determined as described in subsections (2) and (3) below. Such payments by a Subsequent Participating Manufacturer

shall (A) be due on the same dates as the corresponding payments are due from Original Participating Manufacturers; (B) be for the same purpose as such corresponding payments; and (C) be paid, allocated and distributed in the same manner as such corresponding payments.

(2) The base amount due from a Subsequent Participating Manufacturer on any given date shall be determined by multiplying (A) the corresponding base amount due on the same date from all of the Original Participating Manufacturers (as such base amount is specified in the corresponding subsection of this Agreement and is adjusted by the Volume Adjustment (except for the provisions of subsection (B)(ii) of Exhibit E), but before such base amount is modified by any other adjustments, reductions or offsets) by (B) the quotient produced by dividing (i) the result of (x) such Subsequent Participating Manufacturer's applicable Market Share (the applicable Market Share being that for the calendar year immediately preceding the year in which the payment in question is due) minus (y) the greater of *(1)* its 1998 Market Share or *(2)* 125 percent of its 1997 Market Share, by (ii) the aggregate Market Shares of the Original Participating Manufacturers (the applicable Market Shares being those for the calendar

year immediately preceding the year in which the payment in question is due).

(3) Any payment due from a Subsequent Participating Manufacturer under subsections (1) and (2) above shall be subject (up to the full amount of such payment) to the Inflation Adjustment, the Non-Settling States Reduction, the NPM Adjustment, the offset for miscalculated or disputed payments described in subsection XI(i), the Federal Tobacco Legislation Offset, the Litigating Releasing Parties Offset and the offsets for claims over described in subsections XII(a)(4)(B) and XII(a)(8), to the extent that such adjustments, reductions or offsets would apply to the corresponding payment due from the Original Participating Manufacturers. Provided, however, that all adjustments and offsets to which a Subsequent Participating Manufacturer is entitled may only be applied against payments by such Subsequent Participating Manufacturer, if any, that are due within 12 months after the date on which the Subsequent Participating Manufacturer becomes entitled to such adjustment or makes the payment that entitles it to such offset, and shall not be carried forward beyond that time even if not fully used.

(4) For purposes of this subsection (i), the 1997 (or 1998, as applicable) Market Share (and 125 percent thereof) of those Subsequent Participating Manufacturers that either (A) became a signatory to this Agreement more than 60 days after the MSA Execution Date or (B) had no Market Share in 1997 (or 1998, as applicable), shall equal zero.

(j) *Order of Application of Allocations, Offsets, Reductions and Adjustments*. The payments due under this Agreement shall be calculated as set forth below. The "base amount" referred to in clause "First" below shall mean (1) in the case of payments due from Original Participating Manufacturers, the base amount referred to in the subsection establishing the payment obligation in question; and (2) in the case of payments due from a Subsequent Participating Manufacturer, the base amount referred to in subsection (i)(2) for such Subsequent Participating Manufacturer. In the event that a particular adjustment, reduction or offset referred to in a clause below does not apply to the payment being calculated, the result of the clause in question shall be deemed to be equal to the result of the immediately preceding clause. (If clause "First" is inapplicable, the result of clause "First" will be the base amount of the payment in question prior to any offsets, reductions or adjustments.)

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First: the Inflation Adjustment shall be applied to the base amount of the payment being calculated;

Second: the Volume Adjustment (other than the provisions of subsection (B)(iii) of Exhibit E) shall be applied to the result of clause "First";

Third: the result of clause "Second" shall be reduced by the Previously Settled States Reduction;

Fourth: the result of clause "Third" shall be reduced by the Non-Settling States Reduction;

Fifth: in the case of payments due under subsections IX(c)(1) and IX(c)(2), the results of clause "Fourth" for each such payment due in the calendar year in question shall be apportioned among the Settling States pro rata in proportion to their respective Allocable Shares, and the resulting amounts for each particular Settling State shall then be added together to form such Settling State's Allocated Payment. In the case of payments due under subsection IX(i) that correspond to payments due under subsections IX(c)(1) or IX(c)(2), the results of clause "Fourth" for all such payments due from a particular Subsequent Participating Manufacturer in the calendar year in question shall be apportioned among the Settling States pro rata in proportion to their respective Allocable Shares, and the resulting amounts for each particular Settling State shall then be added together. (In the case of all other payments made pursuant to this Agreement, this clause "Fifth" is inapplicable.);

Sixth: the NPM Adjustment shall be applied to the results of clause "Fifth" pursuant to subsections IX(d)(1) and (d)(2) (or, in the case of payments due from the Subsequent Participating Manufacturers, pursuant to subsection IX(d)(4));

Seventh: in the case of payments due from the Original Participating Manufacturers to which clause "Fifth" (and therefore clause "Sixth") does not apply, the result of clause "Fourth" shall be allocated among the Original Participating Manufacturers according to their Relative Market Shares. In the case of payments due from the Original Participating Manufacturers to which clause "Fifth" applies: (A) the Allocated Payments of all Settling States determined pursuant to clause "Fifth" (prior to reduction pursuant to clause "Sixth") shall be added together; (B) the resulting sum shall be allocated among the Original Participating Manufacturers according to their Relative Market Shares and subsection (B)(iii) of Exhibit E hereto (if such subsection is applicable); (C) the Available NPM Adjustment (as determined pursuant to clause "Sixth") shall be allocated among the Original Participating Manufacturers pursuant to subsection IX(d)(3); (D) the respective result of step (C) above for each Original Participating Manufacturer shall be subtracted from the respective result of step (B) above for such Original Participating Manufacturer; and (E) the resulting payment amount due from each Original Participating Manufacturer shall then be allocated among the Settling States in proportion to the respective

results of clause "Sixth" for each Settling State. The offsets described in clauses "Eighth" through "Twelfth" shall then be applied separately against each Original Participating Manufacturer's resulting payment shares (on a Settling State by Settling State basis) according to each Original Participating Manufacturer's separate entitlement to such offsets, if any, in the calendar year in question. (In the case of payments due from Subsequent Participating Manufacturers, this clause "Seventh" is inapplicable.)

Eighth: the offset for miscalculated or disputed payments described in subsection XI(i) (and any carry-forwards arising from such offset) shall be applied to the results of clause "Seventh" (in the case of payments due from the Original Participating Manufacturers) or to the results of clause "Sixth" (in the case of payments due from Subsequent Participating Manufacturers);

Ninth: the Federal Tobacco Legislation Offset (including any carry-forwards arising from such offset) shall be applied to the results of clause "Eighth";

Tenth: the Litigating Releasing Parties Offset (including any carry-forwards arising from such offset) shall be applied to the results of clause "Ninth";

Eleventh: the offset for claims over pursuant to subsection XII(a)(4)(B) (including any carry-forwards arising from such offset) shall be applied to the results of clause "Tenth";

Twelfth: the offset for claims over pursuant to subsection XII(a)(8) (including any carry-forwards arising from such offset) shall be applied to the results of clause "Eleventh"; and

Thirteenth: in the case of payments to which clause "Fifth" applies, the Settling States' allocated shares of the payments due from each Participating Manufacturer (as such shares have been determined in step (E) of clause "Seventh" in the case of payments from the Original Participating Manufacturers or in clause "Sixth" in the case of payments from the Subsequent Participating Manufacturers, and have been reduced by clauses "Eighth" through "Twelfth") shall be added together to state the aggregate payment obligation of each Participating Manufacturer with respect to the payments in question. (In the case of a payment to which clause "Fifth" does not apply, the aggregate payment obligation of each Participating Manufacturer with respect to the payment in question shall be stated by the results of clause "Eighth.")

* * *

XVII. RECOVERY OF COSTS AND ATTORNEYS' FEES

(a) The Original Participating Manufacturers agree that, with respect to any Settling State in which the Court has approved this Agreement and the Consent Decree, they shall

severally reimburse the following "Governmental Entities": (1) the office of the Attorney General of such Settling State; (2) the office of the governmental prosecuting authority for any political subdivision of such Settling State with a lawsuit pending against any Participating Manufacturer as of July 1, 1998 (as identified in Exhibit N) that has released such Settling State and such Participating Manufacturer(s) from any and all Released Claims (a "Litigating Political Subdivision"); and (3) other appropriate agencies of such Settling State and such Litigating Political Subdivision, for reasonable costs and expenses incurred in connection with the litigation or resolution of claims asserted by or against the Participating Manufacturers in the actions set forth in Exhibits D, M and N; provided that such costs and expenses are of the same nature as costs and expenses for which the Original Participating Manufacturers would reimburse their own counsel or agents (but not including costs and expenses relating to lobbying activities).

(b) The Original Participating Manufacturers further agree severally to pay the Governmental Entities in any Settling State in which State-Specific Finality has occurred an amount sufficient to compensate such Governmental Entities for time reasonably expended by attorneys and paralegals employed in such offices in connection with the litigation or resolution of claims asserted against or by the Participating Manufacturers in the actions identified in Exhibits D, M and N (but not including time relating to lobbying activities), such amount to be calculated based upon hourly rates equal to the market rate in such Settling State for private attorneys and paralegals of equivalent experience and seniority.

(c) Such Governmental Entities seeking payment pursuant to subsection (a) and/or (b) shall provide the Original Participating Manufacturers with an appropriately documented statement of all costs, expenses and attorney and paralegal time for which payment is sought, and, solely with respect to payments sought pursuant to subsection (b), shall do so no earlier than the date on which State-Specific Finality occurs in such Settling State. All amounts to be paid pursuant to subsections (a) and (b) shall be subject to reasonable verification if requested by any Original Participating Manufacturer; provided, however, that nothing contained in this subsection (c) shall constitute, cause, or require the performance of any act that would constitute any waiver (in whole or in part) of any attorney-client privilege, work product protection or common interest/joint prosecution privilege. All such amounts to be paid pursuant to subsections (a) and (b) shall be subject to an aggregate cap of $150 million for all Settling States, shall be paid promptly following submission of the appropriate documentation (and the completion of any verification process), shall be paid separately and apart from any other amounts due pursuant to this Agreement, and shall be paid severally by each Original Participating Manufacturer according to its Relative Market Share. All amounts to be paid pursuant to subsection (b) shall be paid to such Governmental Entities in the order in which State-Specific Finality has occurred in such Settling States (subject to the $150 million aggregate cap).

(d) The Original Participating Manufacturers agree that, upon the occurrence of State-Specific Finality in a Settling State, they will severally pay reasonable attorneys' fees to the private outside counsel, if any, retained by such Settling

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State (and each Litigating Political Subdivision, if any, within such Settling State) in connection with the respective actions identified in Exhibits D, M and N and who are designated in Exhibit S for each Settling State by the relevant Attorney General (and for each Litigating Political Subdivision, as later certified in writing to the Original Participating Manufacturers by the relevant governmental prosecuting authority of each Litigating Political Subdivision) as having been retained by and having represented such Settling State (or such Litigating Political Subdivision), in accordance with the terms described in the Model Fee Payment Agreement attached as Exhibit O.

* * *

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EXHIBIT A

STATE ALLOCATION PERCENTAGES

State	Percentage
Alabama	1.6161308%
Alaska	0.3414187%
Arizona	1.4738845%
Arkansas	0.8280661%
California	12.7639554%
Colorado	1.3708614%
Connecticut	1.8565373%
Delaware	0.3954695%
D.C.	0.6071183%
Florida	0.0000000%
Georgia	2.4544575%
Hawaii	0.6018650%
Idaho	0.3632632%
Illinois	4.6542472%
Indiana	2.0398033%
Iowa	0.8696670%
Kansas	0.8336712%
Kentucky	1.7611586%
Louisiana	2.2553531%
Maine	0.7693505%
Maryland	2.2604570%
Massachusetts	4.0389790%
Michigan	4.3519476%
Minnesota	0.0000000%
Mississippi	0.0000000%
Missouri	2.2746011%
Montana	0.4247591%

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Nebraska	0.5949833%
Nevada	0.6099351%
New Hampshire	0.6659340%
New Jersey	3.8669963%
New Mexico	0.5963897%
New York	12.7620310%
North Carolina	2.3322850%
North Dakota	0.3660138%
Ohio	5.0375098%
Oklahoma	1.0361370%
Oregon	1.1476582%
Pennsylvania	5.7468588%
Rhode Island	0.7189054%
South Carolina	1.1763519%
South Dakota	0.3489458%
Tennessee	2.4408945%
Texas	0.0000000%
Utah	0.4448869%
Vermont	0.4111851%
Virginia	2.0447451%
Washington	2.0532582%
West Virginia	0.8864604%
Wisconsin	2.0720390%
Wyoming	0.2483449%
American Samoa	0.0152170%
N. Mariana Isld.	0.0084376%
Guam	0.0219371%
U.S. Virgin Isld.	0.0173593%
Puerto Rico	1.1212774%
Total	100.0000000%

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EXHIBIT J

TOBACCO ENFORCEMENT FUND PROTOCOL

The States' Antitrust/Consumer Protection Tobacco Enforcement Fund ("Fund") is established by the Attorneys General of the Settling States, acting through NAAG, pursuant to section VIII(c) of the Agreement. The following shall be the primary and mandatory protocol for the administration of the Fund.

Section A
Fund Purpose

Section 1

The monies to be paid pursuant to section VIII(c) of the Agreement shall be placed by NAAG in a new and separate interest bearing account, denominated the States' Antitrust/ Consumer Protection Tobacco Enforcement Fund, which shall not then or thereafter be commingled with any other funds or accounts. However, nothing herein shall prevent deposits into the account so long as monies so deposited are then lawfully committed for the purpose of the Fund as set forth herein.

Section 2

A committee of three Attorneys General ("Special Committee") shall be established to determine disbursements from the account, using the process described herein. The three shall be the Attorney General of the State of Washington,

the Chair of NAAG's antitrust committee, and the Chair of NAAG's consumer protection committee. In the event that an Attorney General shall hold either two or three of the above stated positions, that Attorney General may serve only in a single capacity, and shall be replaced in the remaining positions by first, the President of NAAG, next by the President-Elect of NAAG and if necessary the Vice-President of NAAG.

Section 3

The purpose of the Fund is: (1) to enforce and implement the terms of the Agreement, in particular, by partial payment of the monetary costs of the Independent Auditor as contemplated by the Agreement; and (2) to provide monetary assistance to the various states' attorneys general: (A) to investigate and/or litigate suspected violations of the Agreement and/or Consent Decree; (B) to investigate and/or litigate suspected violations of state and/or federal antitrust or consumer protection laws with respect to the manufacture, use, marketing and sales of tobacco products; and (C) to enforce the Qualifying Statute ("Qualifying Actions"). The Special Committee shall entertain requests only from Settling States for disbursement from the fund associated with a Qualifying Action ("Grant Application").

Appendix E

Section E
Administrative Costs

Section 1

NAAG shall receive from the Fund on July 1, 1999 and on July 1 of each year thereafter an administrative fee of $100,000 for its administrative costs in performing its duties under the Protocol and this Agreement. The NAAG executive committee may adjust the amount of the administrative fee in extraordinary circumstances.

Appendix E

EXHIBIT K

MARKET CAPITALIZATION PERCENTAGES

Philip Morris Incorporated	68.0000000%
Brown & Williamson Tobacco Corporation	17.9000000%
Lorillard Tobacco Company	7.3000000%
R.J. Reynolds Tobacco Company	6.8000000%
Total	100.0000000%

Appendix E

EXHIBIT T

MODEL STATUTE

Section __. Findings and Purpose. [1]

(a) Cigarette smoking presents serious public health concerns to the State and to the citizens of the State. The Surgeon General has determined that smoking causes lung cancer, heart disease and other serious diseases, and that there are hundreds of thousands of tobacco-related deaths in the United States each year. These diseases most often do not appear until many years after the person in question begins smoking.

(b) Cigarette smoking also presents serious financial concerns for the State. Under certain health-care programs, the State may have a legal obligation to provide medical assistance to eligible persons for health conditions associated with cigarette smoking, and those persons may have a legal entitlement to receive such medical assistance.

(c) Under these programs, the State pays millions of dollars each year to provide medical assistance for these persons for health conditions associated with cigarette smoking.

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1. [A State may elect to delete the "findings and purposes" section in its entirety. Other changes or substitutions with respect to the "findings and purposes" section (except for particularized state procedural or technical requirements) will mean that the statute will no longer conform to this model.]

(d) It is the policy of the State that financial burdens imposed on the State by cigarette smoking be borne by tobacco product manufacturers rather than by the State to the extent that such manufacturers either determine to enter into a settlement with the State or are found culpable by the courts.

(e) On _____, 1998, leading United States tobacco product manufacturers entered into a settlement agreement, entitled the "Master Settlement Agreement," with the State. The Master Settlement Agreement obligates these manufacturers, in return for a release of past, present and certain future claims against them as described therein, to pay substantial sums to the State (tied in part to their volume of sales); to fund a national foundation devoted to the interests of public health; and to make substantial changes in their advertising and marketing practices and corporate culture, with the intention of reducing underage smoking.

(f) It would be contrary to the policy of the State if tobacco product manufacturers who determine not to enter into such a settlement could use a resulting cost advantage to derive large, short-term profits in the years before liability may arise without ensuring that the State will have an eventual source of recovery from them if they are proven to have acted culpably. It is thus in the interest of the State to require that such manufacturers establish a reserve fund to guarantee a source of compensation and to prevent such manufacturers from deriving large, short-term profits and then becoming judgment-proof before liability may arise.

Appendix E

Section __. Definitions.

(a) "Adjusted for inflation" means increased in accordance with the formula for inflation adjustment set forth in Exhibit C to the Master Settlement Agreement.

(b) "Affiliate" means a person who directly or indirectly owns or controls, is owned or controlled by, or is under common ownership or control with, another person. Solely for purposes of this definition, the terms "owns," "is owned" and "ownership" mean ownership of an equity interest, or the equivalent thereof, of ten percent or more, and the term "person" means an individual, partnership, committee, association, corporation or any other organization or group of persons.

(c) "Allocable share" means Allocable Share as that term is defined in the Master Settlement Agreement.

(d) "Cigarette" means any product that contains nicotine, is intended to be burned or heated under ordinary conditions of use, and consists of or contains (1) any roll of tobacco wrapped in paper or in any substance not containing tobacco; or (2) tobacco, in any form, that is functional in the product, which, because of its appearance, the type of tobacco used in the filler, or its packaging and labeling, is likely to be offered to, or purchased by, consumers as a cigarette; or (3) any roll of tobacco wrapped in any substance containing tobacco which, because of its appearance, the type of tobacco used in the filler, or its packaging and labeling, is likely to be offered to, or purchased by, consumers as a cigarette described in clause (1) of this definition. The term "cigarette"

includes "roll-your-own" (i.e., any tobacco which, because of its appearance, type, packaging, or labeling is suitable for use and likely to be offered to, or purchased by, consumers as tobacco for making cigarettes). For purposes of this definition of "cigarette," 0.09 ounces of "roll-your-own" tobacco shall constitute one individual "cigarette."

(e) "Master Settlement Agreement" means the settlement agreement (and related documents) entered into on _____, 1998 by the State and leading United States tobacco product manufacturers.

(f) "Qualified escrow fund" means an escrow arrangement with a federally or State chartered financial institution having no affiliation with any tobacco product manufacturer and having assets of at least $1,000,000,000 where such arrangement requires that such financial institution hold the escrowed funds' principal for the benefit of releasing parties and prohibits the tobacco product manufacturer placing the funds into escrow from using, accessing or directing the use of the funds' principal except as consistent with section ___(b)-(c) of this Act.

(g) "Released claims" means Released Claims as that term is defined in the Master Settlement Agreement.

(h) "Releasing parties" means Releasing Parties as that term is defined in the Master Settlement Agreement.

(i) "Tobacco Product Manufacturer" means an entity that after the date of enactment of this Act directly (and not exclusively through any affiliate):

(1) manufactures cigarettes anywhere that such manufacturer intends to be sold in the United States, including cigarettes intended to be sold in the United States through an importer (except where such importer is an original participating manufacturer (as that term is defined in the Master Settlement Agreement) that will be responsible for the payments under the Master Settlement Agreement with respect to such cigarettes as a result of the provisions of subsections II(mm) of the Master Settlement Agreement and that pays the taxes specified in subsection II(z) of the Master Settlement Agreement, and provided that the manufacturer of such cigarettes does not market or advertise such cigarettes in the United States);

(2) is the first purchaser anywhere for resale in the United States of cigarettes manufactured anywhere that the manufacturer does not intend to be sold in the United States; or

(3) becomes a successor of an entity described in paragraph (1) or (2).

The term "Tobacco Product Manufacturer" shall not include an affiliate of a tobacco product manufacturer unless such affiliate itself falls within any of (1) - (3) above.

(j) "Units sold" means the number of individual cigarettes sold in the State by the applicable tobacco product manufacturer (whether directly or through a distributor, retailer or similar intermediary or intermediaries) during the year in question, as measured by excise taxes collected by the State on

packs (or "roll-your-own" tobacco containers) bearing the excise tax stamp of the State. The [fill in name of responsible state agency] shall promulgate such regulations as are necessary to ascertain the amount of State excise tax paid on the cigarettes of such tobacco product manufacturer for each year.

Section __. Requirements.

Any tobacco product manufacturer selling cigarettes to consumers within the State (whether directly or through a distributor, retailer or similar intermediary or intermediaries) after the date of enactment of this Act shall do one of the following:

(a) become a participating manufacturer (as that term is defined in section II(jj) of the Master Settlement Agreement) and generally perform its financial obligations under the Master Settlement Agreement; or

(b) (1) place into a qualified escrow fund by April 15 of the year following the year in question the following amounts (as such amounts are adjusted for inflation) —

1999: $.0094241 per unit sold after the date of enactment of this Act;[2]

2000: $.0104712 per unit sold after the date of enactment of this Act;[3]

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2. [All per unit numbers subject to verification.]

3. [The phrase "after the date of enactment of this Act" would need to be included only in the calendar year in which the Act is enacted.]

for each of 2001 and 2002: $.0136125 per unit sold after the date of enactment of this Act;

for each of 2003 through 2006: $.0167539 per unit sold after the date of enactment of this Act;

for each of 2007 and each year thereafter: $.0188482 per unit sold after the date of enactment of this Act.

(2) A tobacco product manufacturer that places funds into escrow pursuant to paragraph (1) shall receive the interest or other appreciation on such funds as earned. Such funds themselves shall be released from escrow only under the following circumstances —

(A) to pay a judgment or settlement on any released claim brought against such tobacco product manufacturer by the State or any releasing party located or residing in the State. Funds shall be released from escrow under this subparagraph (i) in the order in which they were placed into escrow and (ii) only to the extent and at the time necessary to make payments required under such judgment or settlement;

(B) to the extent that a tobacco product manufacturer establishes that the amount it was required to place into escrow in a particular year was greater than the State's allocable share of the total payments that such

manufacturer would have been required to make in that year under the Master Settlement Agreement (as determined pursuant to section IX(i)(2) of the Master Settlement Agreement, and before any of the adjustments or offsets described in section IX(i)(3) of that Agreement other than the Inflation Adjustment) had it been a participating manufacturer, the excess shall be released from escrow and revert back to such tobacco product manufacturer; or

(C) to the extent not released from escrow under subparagraphs (A) or (B), funds shall be released from escrow and revert back to such tobacco product manufacturer twenty-five years after the date on which they were placed into escrow.

(3) Each tobacco product manufacturer that elects to place funds into escrow pursuant to this subsection shall annually certify to the Attorney General [or other State official] that it is in compliance with this subsection. The Attorney General [or other State official] may bring a civil action on behalf of the State against any tobacco product manufacturer that fails to place into escrow the funds required under this section. Any tobacco product manufacturer that fails in any year to place into escrow the funds required under this section shall —

be required within 15 days to place such funds into escrow as shall bring it into compliance with this section. The court, upon a finding of a violation of this subsection, may impose a civil

penalty [to be paid to the general fund of the state] in an amount not to exceed 5 percent of the amount improperly withheld from escrow per day of the violation and in a total amount not to exceed 100 percent of the original amount improperly withheld from escrow;

(B) in the case of a knowing violation, be required within 15 days to place such funds into escrow as shall bring it into compliance with this section. The court, upon a finding of a knowing violation of this subsection, may impose a civil penalty [to be paid to the general fund of the state] in an amount not to exceed 15 percent of the amount improperly withheld from escrow per day of the violation and in a total amount not to exceed 300 percent of the original amount improperly withheld from escrow; and

(C) in the case of a second knowing violation, be prohibited from selling cigarettes to consumers within the State (whether directly or through a distributor, retailer or similar intermediary) for a period not to exceed 2 years.

Each failure to make an annual deposit required under this section shall constitute a separate violation.[4]

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4. [A State may elect to include a requirement that the violator also pay the State's costs and attorney's fees incurred during a successful prosecution under this paragraph (3).]

APPENDIX F — FIRST AMENDED COMPLAINT DATED AND FILED JANUARY 9, 2001

THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
Richmond Division

Civil Action No.: 3:00CV835

STAR SCIENTIFIC, INC.,
a Delaware corporation,
801 Liberty Way
Chester, Virginia 23836-2704

Plaintiff,

v.

MARK L. EARLEY,
in his official capacity as Attorney General
Serve at: 900 East Main Street
Richmond, Virginia 23219

Defendant.

FIRST AMENDED COMPLAINT

Star Scientific, Inc. ("Star Scientific" or "the Company"), for its First Amended Complaint against Mark L. Earley in his official capacity as Attorney General of Virginia, states the following:

Appendix F

Relief Requested

1. Star Scientific in this action challenges the constitutionality of the Master Settlement Agreement ("MSA"), described herein, on the grounds that it violates the Compact and Commerce clauses of the United States Constitution. The Company further asserts that the Qualifying Statute, described herein, violates the Equal Protection, Due Process, Commerce and Taking (without just compensation) clauses of the United States Constitution. Star Scientific seeks a Declaratory Judgment under 28 U.S.C. § 2201 that the challenged provisions of the MSA and the Qualifying Statute are unconstitutional; preliminary and permanent injunctive relief pursuant to 42 U.S.C. § 1983 preventing enforcement against Star Scientific of the challenged provisions; attorneys' fees and costs pursuant to 42 U.S.C. § 1988; and such other relief as the Court deems appropriate.

Introduction

2. Star Scientific occupies a unique position in the tobacco industry. It focuses principally on developing tobacco-processing technology to eliminate, or substantially reduce, certain cancer-causing toxins in tobacco leaf and tobacco smoke. It is the only company to have successfully developed and implemented, on a large-scale and commercially feasible basis, a proprietary tobacco curing process, StarCure™, that eliminates, or substantially reduces, the formation of carcinogenic tobacco specific nitrosamines ("TSNAs") in tobacco and tobacco smoke. TSNAs are considered by knowledgeable and professionally qualified

scientists and medical researchers to be among the most potent and abundant cancer-causing toxins in tobacco and tobacco smoke.

3. In October, 2000, Star Scientific introduced the first very low-TSNA premium cigarette product, *Advance*®, in Richmond, Virginia and Lexington, Kentucky, on an initial test marketing basis. Star Scientific's *Advance*® cigarette product also has a "dalmatian-type" charcoal (carbon)/acetate filter which reduces additional toxic gases such as hydrogen cyanide, benzene and acrolein. In an effort to provide adult tobacco consumers with an opportunity to make informed choices about what they are taking into their bodies, Star Scientific states on the full back of the cigarette package of *Advance*®, and in a precedent-setting informational "package onsert," enhanced health information (well beyond what is required by the Surgeon General), as well as comparative content information involving toxic smoke constituents. Simultaneously, Star Scientific enlarged its health-related website to set forth, in exacting detail, many of the recognized toxic smoke constituents with comparative information regarding *Advance*® and the "three leading lights," so that adult tobacco consumers would have an opportunity to make an informed choice about the tobacco product that they may choose to use. Star Scientific continues to advise adult consumers of its products that "there is no such thing as a safe cigarette" and "it's better to quit than to switch or smoke." Unlike all other tobacco companies, Star Scientific has made repeated public statements to the effect that adult users of its cigarette products should consider "cessation" as their first option.

4. Star Scientific, which also manufactures discount cigarettes, has begun incorporating its very low-TSNA, flue-cured tobacco in its four discount cigarettes and has announced publicly that it will increase the proportion of its very low-TSNA tobacco in its discount cigarettes as it becomes available. Star Scientific did not even commence selling cigarettes to the public until in or about 1994. Star Scientific, and its predecessor companies, have never been named as a defendant in *any* action asserting health-related claims. The Company has a public corporate policy that acknowledges the range of serious health risks associated with cigarette smoking. Star Scientific has acknowledged in its corporate Policy Statement the accuracy of the compendious scientific findings from the Surgeon General's Reports since 1964 regarding the nexus between long-term smoking and a range of serious health hazards. Star Scientific continues to advocate comprehensive regulation of all tobacco-containing products by the lead U.S. health agency, the Food and Drug Administration ("FDA"). Long before the recent Supreme Court decision which affirmed the decision by the Fourth Circuit regarding the Court's determination of the lack of FDA jurisdiction over tobacco, Star Scientific advocated that the Congress move rapidly to enact appropriate legislation over the production, manufacturing, distribution, marketing and advertising of all tobacco containing products. Star Scientific has asserted, repeatedly and publicly, that tobacco products in the 21st Century should be marketed on the basis of good science, and not on the basis of creative marketing and/or advertising approaches.

5. Star Scientific has never targeted young people in its advertising, never deceived the public about the addictive nature of nicotine or the range of health risks associated with smoking, never participated in disseminating any scientific information to undercut the findings of the Surgeon General or the views of the informed public health community to the effect that there is a clear relationship between long-term smoking and a range of diseases and premature death. Indeed, Star Scientific has gone out of its way to attempt to provide the types of public disclosure recommended by the Surgeon General (although not enacted into law) regarding enhanced health warnings on conventional tobacco products.

6. Despite Star Scientific's unique situation, it has been involuntarily subjected to the requirements of the MSA between the attorneys general of 46 states (and six other jurisdictions of the United States) and the major cigarette manufacturers in the United States. The Company has also been subjected to the Qualifying Statute that the MSA required participating states to enact as a condition to receiving a full allocation of funds pursuant to the MSA. (A certified copy of the MSA, as executed by Defendant and attached as an exhibit to the Consent Decree entered by the Circuit Court of the City of Richmond, Virginia on February 23, 1999, is attached hereto as Exhibit 1.) The MSA and the qualifying statute requirement resulted from lawsuits that various states brought against the major cigarette manufacturers alleging misconduct in which Star Scientific has never engaged and never been accused of engaging. In fact, Star Scientific's brief history and public health-oriented positions described above make it effectively impossible for Star Scientific to have been involved in the

sort of malfeasance or misfeasance that these health-related lawsuits against the conventional tobacco companies typically described, as explained below. Nevertheless, the model statute enacted in Virginia, Code of Virginia §§ 3.1-336.1 and 3.1-336.2 (the "Qualifying Statute"),[1] requires Star Scientific and all other cigarette manufacturers that have not joined the MSA and sell cigarettes in Virginia to pay into escrow each year a designated, and an increasingly larger, amount of money per cigarette sold. (A certified copy of 1999 Va. Acts, ch. 714 and 1999 Va. Acts, ch. 754, enacting the Qualifying Statute is attached hereto as Exhibit 2. A copy of Va. Code Ann. §§ 3.1-336.1 and 3.1-336.2 constitutes Exhibit 3.)

7. The major tobacco companies have referred to the "Qualifying Statute" as creating a purported "level playing field." The "Findings and Purposes" section of the Qualifying Statute sets forth its avowed intention to "prevent (non-participating manufacturers from using) a resulting cost advantage to derive large, short-term profits in the years before liability might arise without insuring that the states will have an eventual source of recovery from them if they are proven to act culpably." Ostensibly to effect these "Purposes," the Qualifying Statute starts with an arbitrary and irrational requirement to deposit $1.88 per carton sold, an amount that quickly escalates to, and then remains at, an equally arbitrary and irrational $3.77 per carton. Notwithstanding the avowed purposes of the Qualifying

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1. Similar Qualifying Statutes have been enacted in other states, districts and territories, as mandated for signatories to the MSA in order to receive millions of dollars each year in tobacco settlement funds.

Statutes, the real purpose (not set forth in the legislative language) for requiring states to agree in a virtually unmodified fashion to the mandated Qualifying Statute is to preserve the market share of the major conventional tobacco companies so that these cigarette manufacturers can increase their prices over the next several years (as they have done since the MSA, with its qualifying statute requirement, was announced) in order to pay the $206 billion which they agreed to pay the states without fear of erosion of their combined dominant market share.

8. In short, the MSA and Qualifying Statute in Virginia effectively freeze out competition for any new market entrant like Star Scientific whose central purpose is to develop new technologies which are aimed at lowering the delivery of toxins in tobacco and tobacco smoke, as well as other tobacco products, which it hopes to prove over the next several years would merit the categorization as "reduced risk products" once there is an appropriate health agency, such as the FDA, to review science and make a determination as to the appropriate standards for potentially "less hazardous" and/or "reduced risk" products. The Qualifying Statute enacted by the Virginia legislature serves as a direct disincentive to any new cigarette manufacturer, such as Star Scientific, whose primary focus is the development of tobacco products that deliver less TSNAs and other toxins.

9. The punitive "escrow requirements" are designed to preclude competition by making it financially impossible for a relatively new market entrant, like Star Scientific, to make any real profit after satisfying mandated escrow requirements. As a result, Star Scientific is deprived of funds to continue

the expansion of its research and development efforts. The reality of making the required escrow payment, as Star Scientific did last year (approximately $11.6 million), is to cause it to pay into escrow, and hold for 25 years, more money than its after-tax net income from all sources, including sources not covered by the escrow requirements, such as the processing of its low-TSNA leaf tobacco. The combined punitive effect of the MSA and the Qualifying Statute on Star Scientific constitutes an overwhelming and onerous financial assessment on a company whose primary focus is the continued development of products that deliver less cancer-causing toxins and other toxins, a focus which fulfills the broader purposes set forth by the World Health Organization, as well as the Surgeon General in his recent 29th Report, namely, that cigarette products should be manufactured to have the least hazardous effect possible, given available technologies.

10. Beyond requiring onerous escrow payments from Star Scientific through the required Qualifying Statute, the MSA also significantly and irrationally burdens interstate commerce by: regulating the distribution, promotion and sale of cigarettes in interstate commerce; imposing financial assessments on participating cigarette manufacturers (*i.e.*, MSA signatories) based upon their respective national market shares to fund the general activities of state governments; and prohibiting any lobbying in Congress or in any other forum to weaken or override the terms of the MSA. In short, the MSA and Qualifying Statute insure that Star Scientific will never be able to provide its shareholders with an appropriate return on their investment if it continues to pursue its primary focus, namely, its efforts to develop

smoked and smokeless tobacco products that deliver less toxins that could be candidates to qualify, when appropriate research has been completed, as "reduced risk products."

11. The Virginia Qualifying Statute places a crushing financial burden on innovative and/or public health-oriented cigarette manufacturers such as Star Scientific that have declined to join the MSA. The purpose is to preclude those manufacturers from competing in the sale of cigarettes with cigarette manufacturers that have joined the MSA. The statute also purports to mandate the escrow funds to satisfy hypothetical future claims that the Commonwealth or other participating states might assert someday against cigarette manufacturers that decline to join the MSA. The financial burden that the Virginia Qualifying Statute and virtually identical qualifying statutes enacted by the other settling states place on Star Scientific is substantially greater (in relative terms) than the burden that the MSA imposes on the leading cigarette manufacturers that actively participated in negotiating the terms of the MSA, and is out of all proportion to any reasonably anticipated potential liability to the Commonwealth the Company may have in the future.

Jurisdiction and Venue

12. The Court has jurisdiction under 28 U.S.C. §§ 1331 and 1343.

13. Venue is proper in this Court under 28 U.S.C. § 1391(b) and Rule 3 of the Local Rules of this Court.

Appendix F

The Parties

14. Star Scientific is a public corporation organized under the laws of the State of Delaware, with its principal office in Chesterfield County, Virginia. Star Scientific is a "citizen of the United States or other person within the jurisdiction thereof" within the meaning of 42 U.S.C. § 1983.

15. Mark L. Earley is the Attorney General of Virginia, having been elected to a four-year term in that office by a majority of the Commonwealth's voters in November, 1997. He executed the MSA on behalf of the Commonwealth in his official capacity in 1998. Among other responsibilities, the Attorney General exercises responsibility pursuant to the MSA and is charged by Virginia law with the duty of enforcing the provisions of the Qualifying Statute. Defendant is therefore a "person" acting under color of state law against whom this Court may grant redress under 42 U.S.C. § 1983.

Background

Star Scientific's History, Current Business and Efforts to Effect a Rational Approach to the MSA

16. Star Scientific is a technology-oriented tobacco company with a health-related mission. Its business is focused on the development of proprietary scientific technology for the curing of tobacco so as to prevent, retard or at least significantly reduce the formation of carcinogenic toxins present in tobacco and tobacco smoke, primarily TSNAs; the development of potentially less harmful smoked tobacco products utilizing tobacco with very low levels of TSNAs

(measured in parts per billion) that has been cured using the Company's proprietary StarCure™ tobacco curing process, as well as "dalmatian-type" activated charcoal (carbon)/ acetate filters; the manufacture and sale of discount cigarettes that (in increasing amounts) include Star Scientific's very low-TSNA tobacco, which sales are made through its wholly owned subsidiary, Star Tobacco & Pharmaceuticals, Inc. ("ST&P") (Star Scientific and ST&P being jointly referred to as "Star Scientific"); the development of moist and hard smokeless tobacco products using Star Scientific's very low-TSNA tobacco; and research and development of tobacco cessation products, which would entail securing and/or enlarging Star Scientific's present investigatory new drug ("IND") permits with the FDA and/or filing new INDs to ultimately secure "new drug approval."

17. Star Scientific's overall corporate objective is to reduce the range of serious health hazards associated with the use of tobacco products, particularly smoked tobacco products. To that end, Star Scientific has been striving to demonstrate the commercial viability of less toxic tobacco products and to encourage other tobacco manufacturers to utilize and/or license Star Scientific's proprietary curing technology. The Company has pioneered the development of an economically feasible, non-chemical curing process (StarCure™) for preventing the formation of, or significantly reducing the carcinogenic TSNAs in tobacco and tobacco smoke. The StarCure™ process does not affect the taste, color or nicotine content of tobacco.

18. Star Scientific's proprietary curing process and its articulated goals distinguish it from other tobacco companies.

Appendix F

Star Scientific's goals, initiatives and strategic programs all flow from its recognition of the harsh reality of widespread national and global tobacco use. This reality includes the fact that, according to the Centers for Disease Control and Prevention (United States Department of Health and Human Services), approximately 48 million Americans, or 24.8% of our adult population, use tobacco products on a daily basis and that tobacco causes approximately 435,000 premature deaths per year in the United States. Worldwide, 1.2 billion people use tobacco daily and approximately 4 million of those users will die prematurely this year. Accordingly, Star Scientific agrees with the World Health Organization (Framework Convention on Tobacco Control), as well as the Surgeon General of the United States (29th Report, Executive Summary), that there is an urgent need to reduce the toxicity of tobacco products as much as possible, given available technologies. In that regard, Star Scientific's pioneering proprietary curing technology has been a positive catalyst for real change in the tobacco industry.

19. As part of its broad corporate initiative, Star Scientific introduced in the Commonwealth of Virginia a StarCure™ farming program to enlist qualified tobacco farmers in dramatically changing the way in which they have cured tobacco for the last 100 years. Star Scientific has worked with selected farmers to produce flue-cured tobacco in newly constructed StarCure™ barns which it furnished to the farmers in Virginia and in certain other flue-cured states, at no cost to the farmers. As participating StarCure™ farmers, they are now helping to reduce the problems associated with tobacco use and through their disciplined approach to the production of tobacco during the curing process, as well as

during its cultivation, are able to produce high quality, low-TSNA tobacco. This, in turn, enables them to earn more money per pound on their tobacco production (than the current market price for conventional tobacco), as well as to support a joint commitment to produce tobacco that poses the lowest health hazards possible, given available technology.

20. Star Scientific's Policy Statement of June 1999 (attached hereto as Exhibit 4), which its Board of Directors adopted unanimously, accepts the view of the Surgeon General and other public health experts that conventionally cured tobacco is a major factor in disease and that the use of tobacco generally poses health risks; supports FDA regulation of tobacco; recognizes Star Scientific's corporate responsibility to develop and manufacture tobacco products that pose the lowest health hazards that can be achieved with available technology; acknowledges that adults who choose to use tobacco should be fully informed about its dangers; and commits Star Scientific to work with the FDA, the public health community and others to prevent the use of tobacco by minors.

21. Star Scientific's revenues are generated from the sales of its very low-TSNA tobacco and discount cigarettes through its wholly-owned subsidiary, ST&P. ST&P's predecessor, a closely-held private company, was incorporated in 1990. Between 1990 and 1994, ST&P was engaged primarily in the business of manufacturing cigars and cigarettes for others as a contract manufacturer. In 1994, ST&P began selling its own brand of discount cigarettes using as one of its principal ingredients, Virginia flue-cured

tobacco. At about the same time, Star Scientific commenced a program of research and development relating to a variety of potentially less harmful tobacco products and tobacco cessation products.

22. In order to avoid any confusing signals in the market regarding Star Scientific's long-term objective to eventually remove itself from the conventional cigarette manufacturing business, Star Scientific has contracted with Brown & Williamson Tobacco Corporation ("B&W") for the latter to manufacture a portion of the cigarettes sold under Star Scientific's brand names. B&W manufactures those cigarettes for Star Scientific at its Macon, Georgia facility.

23. Star Scientific is now engaged in distributing and selling cigarettes in interstate commerce. All of the cigarettes manufactured by Star Scientific and those manufactured for Star Scientific in Georgia by B&W are shipped to more than 300 independent distributors and independent wholesalers throughout the United States. Some of those distributors and wholesalers operate in more than one state and often ship cigarettes from their central distribution centers across state lines to their own satellite distribution facilities, to distribution facilities operated by other independent distributors, or directly to retailers.

24. As part of its corporate focus since the mid-1990s, Star Scientific has concentrated on the development of its proprietary StarCure™ tobacco curing process, which virtually precludes or substantially reduces the formation of carcinogenic TSNAs. Respected national and international medical experts and scientific researchers working in several

independent medical institutions have written and published on the evidence that TSNAs are clearly carcinogens in animals, that they are likely carcinogens in humans, that they are potent and abundant in conventional tobacco smoke and that they probably account for some of the many lung cancer deaths in the United States, especially lung adenocarcinomas that occur in smokers. These scientists include, but are not limited to, Professor Stephen Hecht, University of Minnesota; Doctor Deitrich Hoffman and several colleagues at the American Health Foundation; Doctors Spiegelhalder and Bartsch in Germany. Other workers or organizations that have concluded that TSNAs are important factors in human cancers include Professor Idris and coworkers in the Sudan, the International Agency for Research on Cancer and the World Health Organization.

25. The Surgeon General, in several Reports going back many years, urged that the toxicity of tobacco be reduced as much as possible given available technology. In the Surgeon General's most recent (29th) Report, he stated "as with other consumer products, the manufactured tobacco product should be no more harmful than necessary, given available technology."

26. In a parallel fashion, the World Health Organization's Framework Convention on Tobacco Control ("FCTC") stated "there are a number of potential opportunities to make tobacco products less dangerous than they now are." For example, it suggested that an international committee of experts under the supervision of the World Health Organization could "determine which additives contribute to toxicity and addictiveness; [and] set a ceiling

for yields of toxic ingredients such as tobacco-specific nitrosamines and specify progressive reductions. . . ."[2]

27. In 1999, Star Scientific processed more than 3.5 million pounds of its very low-TSNA flue-cured tobacco using its proprietary process. The Company processed approximately 20 million pounds of its very low-TSNA tobacco during the 2000 growing season. Consistent with Star Scientific's long-standing policy to develop less toxic and potentially less harmful tobacco products, the Company has begun integrating its low-TSNA tobacco into its discount cigarette products in increasing proportions as such tobacco becomes available. As a result of expanded production capability for processing its very low-TSNA tobacco, Star Scientific has committed to fully integrate its StarCure™ tobacco into its existing brands of cigarettes within approximately 18 months.

28. On October 2, 2000, Star Scientific introduced the first very low-TSNA cigarette in a limited test market in Richmond, Virginia, and Lexington, Kentucky. This new product, *Advance*®, achieves an approximate 80% reduction of the known carcinogenic TSNAs (NNN and NNK) in tobacco and tobacco smoke (as measured by the International Standards Organization and the Massachusetts Department of Public Health methods), with tar and nicotine yields comparable to those of three leading "lights" brand cigarettes. (Attached hereto as Exhibit 5 is a compilation of charts and tables comparing the smoke constituents of *Advance*® and three leading "lights" cigarette brands.) The product also uses

2. The World Health Organization, FCTC (Spring Paper #2, 1999).

a "dalmatian-type" acetate/charcoal filter that reduces certain gas and vapor phase toxic substances. In addition, Star Scientific has recently announced plans to introduce in 2001 the very first smokeless tobacco products containing all very low-TSNA tobacco.

29. As noted above, in connection with the introduction of its very low-TSNA cigarette, Star Scientific has included enhanced packaging information with the product. For example, the back of each pack of *Advance*® cigarettes states in bold type that: **"THERE IS NO SUCH THING AS A 'SAFE' CIGARETTE."** Each pack of *Advance*® cigarettes also contains an informational "onsert," and the Company has also updated and expanded its website (www.starscientific.com) to present a broad range of accurate, balanced and comprehensive information about *Advance*®, as well as information on the dangers associated with the use of tobacco products, particularly smoked tobacco. (A copy of the "onserts" and the enhanced package warning are attached hereto as Exhibit 6.) Also, Star Scientific has begun the process of including enhanced health warnings on the back of its discount brands of cigarettes. (A copy of the back of the package for its *Vegas*® cigarettes with the expanded health warnings is attached hereto as Exhibit 7.)

30. Star Scientific publicly supported provisions in the 1997 Tobacco Resolution and similar provisions in the subsequent McCain bill that would have promoted the research and development of products that deliver less toxins and are potentially "less hazardous" and/or are candidates for the status as potentially "reduced-risk products."

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31. Since the execution of the MSA, Star Scientific has sought to work with the National Association of Attorneys General ("NAAG") and others participating in the MSA to reach some resolution that would lessen the impact of the MSA and the related qualifying statutes on a company such as Star Scientific, which has endeavored to develop less toxic and potentially less carcinogenic tobacco products.

32. After weeks of preliminary communications, Star Scientific met in February 1999 with Attorney General Christine Gregoire of the State of Washington (then the head of the NAAG Tobacco Committee) and representatives of other MSA participants and proposed a specific amendment to the MSA that would have permitted Star Scientific to become a "subsequent participating manufacturer," while taking into account Star Scientific's efforts to develop less harmful tobacco products, the diversionary impact that such efforts had had on Star Scientific's market share in the MSA benchmark years of 1997 and 1998, and the fact that the MSA would effectively punish Star Scientific for its focus on financially demanding developmental efforts and deprive it of resources necessary to continue its technological advancements.

33. Between February 1999 and shortly before the date of the commencement of this action, Star Scientific continued to seek a resolution with NAAG under which it would be permitted to become a "subsequent participating" party to the MSA, but with certain modifications and concessions in light of Star Scientific's efforts to develop less toxic tobacco products and the absence of any evidence that Star Scientific has ever engaged in the type of conduct

alleged against original participating manufacturers ("OPMs"). Star Scientific's approach to NAAG included a proposal for NAAG to adopt a resolution expressing its support for the development of less toxic tobacco products. That approach also included the submission of a specific settlement proposal to NAAG at its Spring 2000 meeting and further discussion of this and other proposals at NAAG's annual meeting in June 2000 and thereafter, including a final negotiating session on December 11, 2000, at NAAG's offices in Washington, D.C.

34. Unlike conventional tobacco manufacturers whose focus has been on advertising and marketing to increase their respective market shares, Star Scientific's focus in 1997 and 1998 was on the research and development of a commercially feasible process for producing large quantities of very low-TSNA tobacco. In fact, the Company's revenues from the sales of cigarettes declined substantially in 1997 and 1998 from prior year levels due, in part, to its focus on developing its technology for tobacco curing that would enable it to be in a position to produce tobacco products that deliver less toxins and are potentially less hazardous. Consequently, if Star Scientific had joined the MSA as a subsequent participating manufacturer, it would have been subject to substantial settlement obligations for any sales above 125% of its 1997 sales, which were approximately $20.7 million and would have been required in effect to concede that it had engaged in the type of conduct alleged against the OPMs.

35. Had Star Scientific signed the MSA as a subsequent participating manufacturer, it would have been required to make payments under the MSA in the amount of

approximately $19.8 million during 2000, based on its 1999 cigarette sales of approximately $90 million. Moreover, given the structure of the MSA, which is designed to maintain the market shares of the OPMs, Star Scientific's obligations would increase dramatically in response to any future increases in market share above 125% of 1997 levels. The impact of such potential payments would destroy Star Scientific's profitability in the inelastic discount cigarette market and, for all practical purposes, prevent the further development and sale of low-TSNA cigarette products. For this reason, Star Scientific did not join the MSA.

Star Scientific's Treatment as a Non-Participating Manufacturer

36. As a "non-participating manufacturer" ("NPM") within the meaning of the MSA, *i.e.*, a non-signatory, Star Scientific will fare even worse than as a subsequent participating manufacturer. It is required to escrow from after-tax dollars increasingly large amounts that will exceed its entire net income. These amounts are ostensibly reserved (by the terms of the Qualifying Statute and others like it) to satisfy future, speculative judgments or settlements arising from any future health-related lawsuits that might be brought against Star Scientific by the settling states. To date, none of those states has asserted any health-related claims against Star Scientific and, as noted above, Star Scientific has never been sued on any health-related claims. By contrast, no payments by the OPMs are required to be reserved for future health related lawsuits. Payments pursuant to the MSA are available to the states to use for a broad variety of purposes. Indeed, although it has been stated by many attorneys general

in several states outside of Virginia that the MSA ushers in a new era of focus on reducing the harm associated with long-term smoking, several of these states committed varying portions of the moneys received under the settlement for, among other things, debt reduction, road building and a variety of other state governmental services having nothing to do, directly or indirectly, with reducing the mortality or morbidity associated with long-term cigarette use.

37. In April 2000, Star Scientific deposited a total of $11,605,155.02 into escrow, which amount exceeded Star Scientific's net income in 1999 of $11,514,000 from *all* sources. Had the Qualifying Statutes been in effect in all MSA-signatory states and territories for the entire year of 1999, Star Scientific's escrow obligation would have been substantially more onerous. The size of the escrow payments and the requirements that they be held for a period of 25 years have the practical effect of forfeiting what would otherwise be available working capital. The escrow requirement destroys Star Scientific's ability to use its corporate assets to invest in further research and development of potentially less hazardous tobacco products, particularly smokeless tobacco products. These products may well hold the promise of truly reducing the mortality and morbidity associated with long-term smoking in a fashion similar to what has been achieved in Sweden by the significant movement from smoked to smokeless tobacco using smokeless products which deliver less carcinogenic TSNAs than comparable smokeless products sold outside of Sweden, although not at the low levels Star Scientific has achieved through its process. Moreover, the increasingly large escrow obligations mandated in future years will continue to outstrip

Star Scientific's net income from all sources. For example, Star Scientific's estimated escrow obligation from after-tax dollars for the year 2000 will be substantially more than its net income after taxes.

38. Unless the enforcement of the provisions of the MSA and the Qualifying Statute is enjoined, Star Scientific's ability to continue its research and development of potentially less hazardous tobacco products which deliver less toxins will be destroyed, as will its ability to make available to adult users of tobacco products new Star Scientific-generated products which deliver less toxins and which the Company hopes will be able to secure a designation, after adequate research is conducted, as "reduced risk products." If the present irrational and arbitrary scheme mandated by the MSA and Qualifying Statute continues, Star Scientific will not be able to act as a positive catalyst for change within the conventional tobacco industry. The impact of the MSA and the Qualifying Statute imposes very real and substantial injury that the Company will continue to suffer unless the enforcement of the MSA and the Qualifying Statute is enjoined.

The Tobacco Industry in the United States

39. In or about November 1998, when the MSA was announced by NAAG, the major tobacco companies represented approximately 98% of the U.S. cigarette market. The production of cigarettes in the United States has been and continues to be highly concentrated, with the five leading cigarette manufacturers still occupying approximately 98% of the national cigarette market in 1999. Philip Morris

Incorporated accounted for almost 50% of all the cigarettes sold in this country last year; R.J. Reynolds Tobacco Company, approximately 23%; B&W, approximately 13.5%; Lorillard Tobacco Company, approximately 10.5%; and Liggett Group, approximately 1%. By contrast, Star Scientific's cigarette sales in 1999 accounted for less than 1% of the U.S. market.

40. In general, there are three price categories of cigarettes sold in the United States: premium brands, full price brands and discount brands. The third category, discount brands, historically has accounted for less than 3% of the national cigarette market. With the exception of the test market for its *Advance*® cigarette, Star Scientific manufactures and sells cigarettes exclusively in the discount category, which is highly inelastic in terms of price.

41. Approximately 99% of all cigarettes sold in the United States are manufactured in six domestic facilities and ultimately shipped by cigarette manufacturers to thousands of wholesalers, jobbers and distributors, who in turn ship to thousands of retailers in every state.

Commencement of Tobacco Litigation by the States

42. In 1994, the attorneys general of Mississippi, Minnesota, West Virginia and Massachusetts filed separate actions in their respective state courts against the major tobacco companies seeking reimbursement for health care expenditures that those states had made on behalf of citizens suffering from tobacco-related diseases. Thereafter, other

states commenced similar actions. Star Scientific was not named as a defendant in any of these cases, and has never been sued on the basis of any health-related claim.

43. On June 20, 1997, a group of state attorneys general announced a comprehensive, nationwide settlement of claims against the major tobacco companies. This proposed settlement, known as "the Tobacco Resolution," was, by its terms, contingent upon congressional approval. (A copy of the Tobacco Resolution is attached hereto as Exhibit 8.)

44. The Tobacco Resolution was premised on the agreement by the leading cigarette manufacturers to pay significantly higher taxes, accept FDA regulation of tobacco, and restrict marketing and advertising of cigarettes, all in exchange for broad immunity from further civil liability (including a cap on annual damage payments and protection against state class action suits and punitive damages for past conduct). The Tobacco Resolution also contained specific provisions that were designed to encourage and foster the development of less toxic, and less harmful, tobacco products.

Congressional Consideration of the Tobacco Resolution

45. Federal legislation to implement the Tobacco Resolution was introduced on November 5, 1997, as S. 1415 ("the National Tobacco Policy and Youth Smoking Reduction Act"). Other legislation to achieve the same end was subsequently introduced, but the initial proposal, S. 1415, known popularly as "the McCain bill," became the principal focus of congressional attention and activity. Like the

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Tobacco Resolution, the McCain bill included specific provisions that would provide incentives to conventional tobacco manufacturers, as well as new market entrants, to produce potentially less hazardous products and/or products having the potential of being designated as a "reduced risk product" by the Food and Drug Administration. On May 1, 1998, the Senate Commerce Committee reported the McCain bill to the full Senate. (A copy of § 913 of S. 1415 as the Commerce Committee reported it is attached hereto as Exhibit 9.) It differed from the Tobacco Resolution in several respects, the most important being:

a) S. 1415 would have required cigarette manufacturers to pay $516 billion (as opposed to $368.5 billion under the Tobacco Resolution) over 25 years to help states and the federal government bear the medical expenses of tobacco-related diseases;

b) S. 1415 would have imposed an additional $1.10 per pack federal tax to be phased in over five years;

c) S. 1415 would have provided for FDA regulation of the tobacco industry to a greater degree than that contemplated by the Tobacco Resolution; and

d) S. 1415 would have provided for a more drastic reduction in permitted cigarette marketing, advertising and promotion than did the Tobacco Resolution.

46. In the months following the announcement of the Tobacco Resolution, the major tobacco companies reached

individual settlements with four states: Mississippi on July 2, 1997; Florida on August 25, 1997; Texas on January 16, 1998; and Minnesota on May 8, 1998. The terms of these individual settlements differed substantially from the terms of both the Tobacco Resolution and S. 1415.

47. On June 17, 1998, the McCain bill effectively died in the Senate when both a motion to limit debate on the bill and a separate motion to waive the requirements of the Budget Act failed to secure the sixty votes required for approval of each motion. These votes brought to an end any effort to pursue congressional action on the Tobacco Resolution in the 105th Congress.

Negotiation of the MSA and Model Statute

48. After the defeat of the McCain bill, several state attorneys general initiated negotiations with two of the major tobacco companies in an effort to reach a new multi-state settlement. These negotiations focused on settlement terms that were narrower and more favorable to the tobacco companies than either the Tobacco Resolution or the McCain bill.

49. These parties successfully concluded negotiations on a new settlement agreement (the MSA) on November 16, 1998. They also released the MSA to those attorneys general who had not participated in the settlement negotiations at that time. Those non-participating attorneys general were given seven days to review the MSA's terms and decide whether to join it. The original signatories formally executed

the MSA on November 23, 1998. Thereafter, the original parties to the MSA gave other cigarette manufacturers a short period of time to join the MSA, and several did so.

50. The MSA differs from the Tobacco Resolution and S. 1415 in several significant respects, including: its omission of any incentive for the development of less harmful tobacco products; its treatment of the payments to be made by cigarette manufacturers as "damages" paid in "settlement" of the states' claims rather than as taxes; the omission in the MSA of any provision for FDA regulation of cigarettes; the omission in the MSA of any immunity for manufacturers, except as to claims of the settling states, from civil liability or limits on punitive damages or annual payments of civil compensatory damages to parties; the inclusion in the MSA of a ban on any lobbying to weaken the terms of the MSA; and the omission in the MSA of any provision for congressional approval of its terms.

51. The MSA purports to settle all claims included in the then-pending actions commenced by various states and all similar claims that might have been asserted by the other settling states. The claims precluded are not only those for past conduct, but also claims based on future conduct. The terms of the MSA required each settling state to seek the entry of an order dismissing the state's claims against participating manufacturers in the form of the model consent decree attached to the MSA as Exhibit "L."

52. Payments by participating manufacturers pursuant to the MSA are made, not to the individual states, but to a central depository, which is referred to in the MSA as the "Escrow Agent."

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53. The claims that the various states asserted in their actions against the leading cigarette manufacturers were based on charges that, for several decades, the manufacturers had engaged in fraudulent and deceptive practices to induce individuals, particularly minors, to smoke cigarettes, and that they were guilty of conduct in violation of antitrust laws, unfair competition laws and even the federal Racketeer Influenced and Corrupt Organizations statute ("RICO"). The allegations included charges that the leading cigarette manufacturers had conspired to mislead the public about the addictive properties of nicotine and the harmful effects of tobacco use; that they had conspired to suppress the development of less harmful tobacco products; and that they had aggressively targeted minors in their advertising and promotion programs. The states requested reimbursement for the public funding of health care provided to individuals suffering from diseases associated with cigarette smoking.

54. A copy of the Bill of Complaint that the Virginia Attorney General filed in the Circuit Court of the City of Richmond on December 23, 1998 (a certified copy of which is attached hereto as Exhibit 10) as a predicate for the Commonwealth's joinder in the MSA is to similar effect. It contained claims under the Virginia Antitrust Act, the Virginia Consumer Protection Act, and for common law "unjust enrichment/restitution." The Attorney General specifically charged that the defendant tobacco companies (which included all four OPMs) had conspired with one another since the early 1950s to "mislead and confuse the public about the dangers of tobacco." In particular, the conspirators (which did *not* include defendant Liggett): (a) misrepresented the health effects of tobacco and smoking;

(b) suppressed research relating to the dangers of cigarettes, "while purporting to provide honest, unbiased information regarding the safety of tobacco and cigarettes"; (c) misled the public about the addictive qualities of nicotine; (d) agreed among themselves not to conduct research on the issue of health and tobacco; and (e) suppressed research about the development and marketing of safer tobacco products. The conspiracy alleged in the Bill of Complaint also included the targeting of underage persons in the conspirators' advertising and marketing campaigns to induce young people to start using tobacco products. Significantly, the Attorney General made these allegations of egregious misconduct even *after* the Commonwealth's settlement agreement with the defendant tobacco companies was already in place.

55. The MSA provides that each participating state entitled to an allocation of the payments made by participating manufacturers pursuant to the MSA must enact a qualifying statute either in the form of the model statute contained in Exhibit "T" of the MSA without substantive modification or addition or a substantially equivalent statute in order to avoid a substantial reduction in, or possible elimination of, the state's allocated payments. The Virginia General Assembly enacted its Qualifying Statute in March 1999, adopting the model statute (Exhibit "T" to the MSA) without substantive amendment (Exhibit 2). The MSA's stated purpose for the Qualifying Statute is to fully neutralize the cost disadvantages that participating manufacturers would otherwise experience vis-à-vis NPMs in the sale of cigarettes as a result of the payments that participating manufacturers are to make under the MSA. The Qualifying Statute requires all cigarette manufacturers selling cigarettes either to join

the MSA or to make annual after-tax payments to an escrow fund of increasingly large amounts of money per cigarette sold in the Commonwealth during the preceding year, as well as a cumulative inflation adjustment of at least 3% per year on such escrow obligations. Despite the clearly anti-competitive purpose for the Qualifying Statute that the MSA itself articulates, the annual payment to the escrow fund is purportedly reserved exclusively for the purpose of satisfying health-related claims that the Commonwealth *might* assert against the manufacturer for 25 years following each annual escrow payment.

56. As construed by NAAG, the MSA's qualifying statute requirement has the effect of regulating cigarette manufacturers that have declined to become parties to the MSA even in states where they conduct no business by requiring them to make escrow payments measured by the volume of cigarettes bearing their brand that are sold in those states by independent distributors over which the NPMs exercise no control.

57. On November 9, 1999, the Virginia Supreme Court removed the last obstacle to Virginia's entitlement to receipt of its allocation of funds pursuant to the MSA. The Court dismissed the only appeal from the Consent Decree entered by the Circuit Court of the City of Richmond, which approved the Defendant's execution of the MSA. This dismissal allowed the Commonwealth to achieve "State Specific Finality" within the meaning of MSA § II(ss). One week later, the Defendant Attorney General announced the formal acknowledgement and agreement of the participating manufacturers that the Commonwealth had attained State

Specific Finality. As a result, Virginia received its first "Allocated Payment" under the terms of MSA, amounting to approximately $50 million in December 1999.

58. The effect of the MSA and its qualifying statute requirement is to regulate and control the national market in cigarettes. The terms of the MSA as negotiated by the state attorneys general and the OPMs effectively coerce other, smaller manufacturers to join the MSA as parties, maintain their market shares at 1997 or 1998 levels, and to submit to the regulations that the MSA imposes in order to avoid the more onerous financial burden that the model statute or its equivalent imposes.

Developments Since the MSA Was Executed

59. Since the MSA was executed in 1998, many new companies have begun selling cigarettes in the United States. Some of these new companies are NPMs that are not making, and do not intend to make, escrow payments pursuant to any qualifying statute. Another group includes new companies that have been established or financed by, or are affiliated with, participating manufacturers, and are selling in both settling and previously settling states (*i.e.*, Florida, Minnesota, Mississippi and Texas), and have yet to make escrow payments pursuant to the qualifying statutes. A third group includes new companies that are not manufacturers and that import cigarettes and sell to distributors in settling states with no intention of making escrow payments pursuant to qualifying statutes in those states. Some of these new companies are also selling products, such as Bidis, that

resemble conventional cigarettes but deliver, in the opinion of leading public health authorities, even more carcinogens than conventional cigarettes.

60. Notwithstanding the activities of these new cigarette companies, the settling states and the NAAG Tobacco Committee have focused their attention and enforcement efforts on Star Scientific's lawful sales to distributors in previously settling states in an attempt to coerce Star Scientific to join the MSA and to punish Star Scientific for having declined to do so. Unlike payments by participating manufacturers, escrow payments by NPMs do not add to the current revenues of any of the states. Among NPMs, Star Scientific has the highest volume of revenues from the sale of cigarettes and, for that reason, has become a troublesome problem for NAAG. Star Scientific's non-participation in the MSA highlights a fundamental weakness in the MSA — the fact that cigarettes sold by NPMs in previously settling states (which have no escrow requirement) can be sold at prices substantially below prices for similar cigarettes sold in settling states where the cost of the escrow requirement is reflected in higher cigarette prices.

61. The increase in cigarette sales in previously settling states is the inevitable result of the cost differential between cigarette sales in those states and cigarette sales in the settling states, which have imposed burdensome escrow requirements on NPMs. An NPM is able to sell cigarettes at a lower price to an independent distributor in a state having no statutory escrow requirement than it could to a distributor in a state that has such a requirement.

62. On November 22, 2000, W.A. Drew Edmondson, in his capacity as Attorney General of Oklahoma and as Chairman of the NAAG Tobacco Committee, wrote to the President of Star Scientific asserting that Star Scientific was selling cigarettes to distributors in states that are not parties to the MSA with the understanding that, if those distributors resell the cigarettes within a settling state, Star Scientific would not be required to make escrow payments reflecting sales by those distributors in states that have enacted a qualifying (or "non-participating manufacturer") statute pursuant to § IX of the MSA. (A copy of Mr. Edmondson's letter is attached hereto as Exhibit 11.) Mr. Edmondson has improperly construed the Oklahoma qualifying statute and similar statutes in other settling states to require every NPM to make escrow payments based upon the total volume of sales of its cigarettes that are subject to the Oklahoma excise tax regardless of whether the initial sale of those cigarettes by the NPM to independent distributors has been concluded entirely outside of Oklahoma and the NPM transacts no business in Oklahoma. This construction of the qualifying statutes unconstitutionally extends the jurisdiction and power of the settling states.

63. The qualifying statute enacted by every settling state contains language identical or virtually identical to the language in the Oklahoma statute construed by Mr. Edmondson. These qualifying statutes subject Star Scientific and every other NPM to the risk of inconsistent regulation by the settling states. The question of whether and to what extent a qualifying statute has extraterritorial effect, as claimed by Mr. Edmondson, is subject to a different answer in each settling state. If settling states adopt inconsistent

constructions of the pertinent language of the model legislation (Exhibit "T" to the MSA), Star Scientific and other NPMs would be required to make multiple and unfair escrow payments with respect to the same cigarettes to the extent cigarettes are sold to distributors in one settling state and are then resold in another settling state.

64. Unlike the major cigarette manufacturers, Star Scientific has facilities, employees and agents in only a handful of states. With few exceptions, it sells cigarettes directly to independent distributors that are licensed by one or more states. These distributors are not Star Scientific agents and are not controlled by Star Scientific. Title and control over Star Scientific cigarettes are relinquished to those distributors when Star Scientific delivers its product to them. Star Scientific does not receive or maintain information about the location of the retail sales of cigarettes it has previously sold. These independent distributors have no corporate affiliation with Star Scientific and, therefore, could not be considered to be intermediaries of Star Scientific within the meaning of the qualifying statutes.

* * *

Appendix F

ONSERT A

ADVANCE®

STAR is providing this series of information strips so adult consumers can make informed choices.

Star

STAR wants you to KNOW about:

Measuring TOXINS in Smoke

There are thousands of different tiny chemical particles in cigarette smoke. These can be measured. A smoking machine puffs cigarettes in a standard way. A filter pad traps the particles and a device collects the gases small enough to pass through the pad. The chemicals are then measured by other techniques.

Different smoking methods use different "settings" for how big the puffs are, how often they are taken, etc. The F.T.C. method has been in use for over thirty years and is used to get the "tar" and nicotine levels that are printed on cigarette ads.

This method has been criticized for not "smoking" the way people actually smoke and coming up with unrealistically low numbers. For example, smokers sometimes block the tiny holes in some filter tips and this increases the amounts of tar and nicotine they actually get. The Massachusetts (MA) method blocks 50% of the filter holes and takes larger, more frequent puffs. The numbers it produces may be more realistic for smokers of "lights" and "ultra-lights."

over

The following Table shows SOME results of independent laboratory testing of ADVANCE using both the FTC and MA methods.

INDEPENDENT LAB TESTS OF ADVANCE (AV) COMPARED TO THE AVERAGE OF THREE LEADING LIGHTS BRANDS (LL)

F.T.C. method

Toxin	LL	AV	% ↑ or ↓
Tar[a]	10.7	9.8	↓8
Nicotine[a]	0.8	0.8	0
CO[a]	12.2	9.1	↓25

Massachusetts method

Toxin	LL	AV	% ↑ or ↓
Tar[a]	22.7	20.8	↓8
Nicotine[a]	1.7	1.7	0
CO[a]	22.6	18.7	↓17
TSNA NNN[c]	281.0	73.0	↓74
TSNA NNK[c]	193.7	30.2	↓84
TSNA NAT[c]	247.5	93.5	↓62
TSNA NAB[c]	43.1	10.4	↓76
Total TSNA[c]	765.4	207.1	↓73
Acrolein[b]	108.6	102.0	↓6
Formaldehyde[b]	55.3	81.2	↑47
Acetaldehyde[b]	1035.9	963.6	↓7
Benzene[b]	78.6	66.9	↓15
Nickel[c]	7.3	7.7	↑5
Nitric Oxide[b]	465.0	204.1	↓56
Benzo(a)pyrene[c]	20.0	18.4	↓8
Hydrogen Cyanide[b]	300.1	210.2	↓30

Units: a = mg/cig; b = ug/cig; c=ng/cig
Table Values and %'s are rounded

↓ LOWER IN ADVANCE
↑ HIGHER IN ADVANCE

ADVANCE uses tobacco cured in special STARCURE™ barns and a special charcoal filter. These steps lower total TSNAs by more than 70% and reduce SOME toxic gases compared to leading "light" brands. TSNAs are a group of potent cancer-causing chemicals.

It is not yet known if reducing TSNAs and other toxins will lower YOUR health risks.

THERE IS NO SUCH THING AS A "SAFE" CIGARETTE.

For more toxin data and other information, go to our website at: www.starscientific.com and read the other information strips in this series.

PACK ONSERT 15-0780B

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Appendix F

ONSERT B

ADVANCE®

STAR is providing this series of information strips so adult consumers have a sound basis for making informed choices.

Star

Star wants you to KNOW:

THERE IS NO SUCH THING AS A "SAFE" CIGARETTE!

There are more than 4,000 different chemicals in cigarette smoke. About 40 of these are thought to be carcinogens (cancer-causing chemicals). Some of the non-carcinogens may play a role in causing lung damage or heart disease. Since most of the carcinogens are found in the "tar" part of the smoke, one approach to reducing the health hazards of smoking has been to lower tar.

For many years, tar levels have been measured by smoking each brand on a smoking machine. The settings on the machine (the size and number of puffs, etc.) were specified by the Federal Trade Commission and all cigarettes were smoked in the same manner.

By adding filters and putting tiny ventilation holes in the filters, cigarette makers developed many brands which tested as having reduced tar and nicotine even though the tobacco itself was relatively unchanged.

Because many smokers smoke to get nicotine, they tend over

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to smoke more intensely when smoking "lights" or "ultra-lights".

This "compensation" is achieved by taking bigger, deeper, or more frequent puffs, or by having more cigarettes. As a result their exposure to toxins may not be really reduced. This is why "lights" and "ultra-lights" are NOT NOW viewed by health scientists as reliably less hazardous.

Using a different approach, STAR has actually reduced some toxins in the tobacco itself.

ADVANCE cigarettes use tobacco cured in special STAR-CURE™ tobacco barns to prevent or reduce the formation of tobacco-specific nitrosamines (TSNAs), a group of potent cancer-causing chemicals in tobacco and tobacco smoke.

Total TSNA levels in ADVANCE are more than 70% lower than levels found in the leading "light" brands.

ADVANCE also uses a special charcoal filter to reduce SOME toxic gases in cigarette smoke.

ALL SMOKED TOBACCO PRODUCTS ARE ADDICTIVE AND POSE SERIOUS HEALTH HAZARDS.

It is not yet known if reducing TSNAs and other toxins will lower YOUR health risks.

IT IS STILL BETTER TO QUIT THAN TO SWITCH OR SMOKE.

For more information, go to our website at: www.starscientific.com and read the other information strips in this series.

PACK ONSERT 15-0780A

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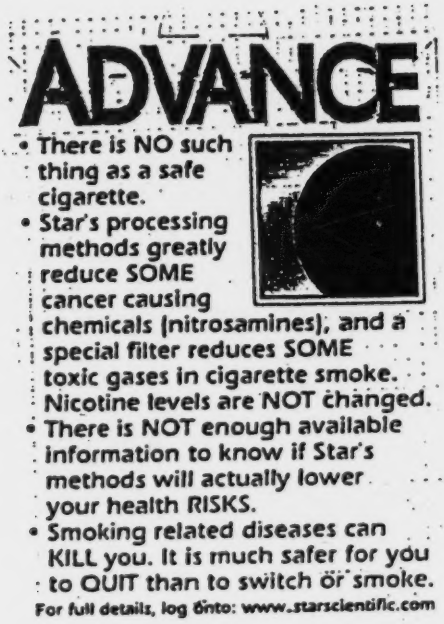
ADVANCE
• There is NO such thing as a safe cigarette.
• Star's processing methods greatly reduce SOME cancer causing chemicals (nitrosamines), and a special filter reduces SOME toxic gases in cigarette smoke. Nicotine levels are NOT changed.
• There is NOT enough available information to know if Star's methods will actually lower your health RISKS.
• Smoking related diseases can KILL you. It is much safer for you to QUIT than to switch or smoke.
For full details, log onto: www.starscientific.com